Link to Final Agency Decision
OAH Docket No. 4-1800-15288-2

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE COMMISSIONER OF HUMAN SERVICES

In the Matter of the Rate Appeal of Foundation for Rural Health Care, d/b/a McIntosh Manor, Crestview Care Center and Pelican Lake Care Center	**FINDINGS OF FACT, CONCLUSIONS, AND RECOMMENDATION**

This matter came on for hearing before Administrative Law Judge Bruce H. Johnson on August 22 through September 1, 2005, at the Office of Administrative Hearings, 100 Washington Avenue South, Suite 1700, Minneapolis, MN. The parties submitted post-hearing briefs on October 21, 2005, and responsive briefs on November 14, 2005. The hearing record closed on November 21, 2005, when all of the parties' post-hearing submissions were received.

David A. Rowley, Amber Hawkins, and Barry R. Greller, Assistant Attorneys General, 445 Minnesota Street, Suite 900, St. Paul, MN 55101-2127, appeared on behalf of the Department of Human Services ("Department").

Samuel D. Orbovich, Orbovich & Gartner, 408 St. Peter Street, Suite 417, St. Paul, MN 55102-1187, appeared on behalf of the Foundation for Rural Health Care ("Foundation").

NOTICE

This Report is a recommendation, not a final decision. The Commissioner of Human Services will make the final decision after a review of the record. The Commissioner may adopt, reject or modify the Findings of Fact, Conclusions, and Recommendations. Under Minn. Stat. § 14.61, the final decision of the Commissioner shall not be made until this Report has been made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by this Report to file exceptions and present argument to the Commissioner. Parties should contact Kevin Goodno, Commissioner, Department of Human Services, 444 Lafayette Road, St. Paul, MN 55155 to learn the procedure for filing exceptions or presenting argument.

If the Commissioner fails to issue a final decision within 90 days of the close of the record, this report will constitute the final agency decision under Minn. Stat. § 14.62, subd. 2a. The record closes upon the filing of exceptions to the report and the

presentation of argument to the Commissioner, or upon expiration of the deadline for doing so. The Commissioner must notify the parties and the Administrative Law Judge of the date on which the record closes.

Under Minn. Stat. § 14.62, subd. 1, the Department is required to serve its final decision upon each party and the Administrative Law Judge by first class mail or as otherwise provided by law.

STATEMENT OF ISSUE

Was it appropriate for the Department to disallow increases in the property-related rates of Crestview Manor, Pelican Lake Care Center, and McIntosh Manor, after those facilities were sold to the Foundation for Rural Health Care by corporations owned by Robert F. Odell because the sales were between "related organizations," within the meaning of Minn. Stat. § 256B.431, subd. 14?

The Administrative Law Judge concludes that those sales were between related organizations, and that it was appropriate for the Department to disallow increases in the property-related rates of the three facilities.

Based upon the proceedings herein, the Administrative Law Judge makes the following:

FINDINGS OF FACT

Background Information

1. Prior to 1983, the family of Robert F. Odell ("Mr. Odell") owned and operated three nursing homes known as Pelican Lake Care Center, Crestview Manor, and McIntosh Manor (hereinafter collectively "the Odell Nursing Homes") as a closely-held family business for many years.[1] The family had acquired the Pelican Lake Health Care Center in Ashby, Minnesota in 1957, McIntosh Manor Nursing Home in McIntosh, Minnesota in 1963, and Crestview Manor Nursing Home in Evansville, Minnesota in 1967.[2]

2. Mr. Odell, his father and mother, and his two brothers were all actively involved in that nursing home business. Mr. Odell was the oldest of the three siblings, and his active involvement in the family business began in 1967 after he was discharged from the Army.[3] Mr. Odell's father passed away in 1973, after which Mr. Odell, his mother, and his two younger brothers continued to operate the Odell Nursing

[1] Transcript (Tr.) 937, 940.
[2] Tr. 936-37.
[3] Tr. 937-38.

Homes until 1983.[4] In that year, Mr. Odell took over sole management of the nursing homes.[5]

3. At some point, separate closely-held corporations had been created to own each of the three facilities—namely, Crestview Manor, Inc., Pelican Lake Health Care Center, Inc., and McIntosh Manor, Inc. (hereinafter collectively "the Odell Corporations").[6] By 1998, Mr. Odell was the sole shareholder of the Odell Corporations.[7] He also organized a fourth closely-held corporation, of which he was sole owner, as a management company to manage the Odell Nursing Homes. In 1997, the name of that fourth corporation was Central Health Care Management, Inc. ("Central Health Care").[8]

4. In the early 1990s, Coral Blaze ("Ms. Blaze") worked as a pool nurse at another nursing home owned by Mr. Odell in Cannon Falls, Minnesota. She subsequently became a full-time employee there and eventually became its Director of Nursing.[9] Sometime in 1994, about a year after Mr. Odell and his wife were divorced, Ms. Blaze and Mr. Odell began a personal romantic relationship.[10]

5. In about 1995, Mr. Odell offered Ms. Blaze a position in Central Health Care Management, and she accepted. Her position there involved direct supervision of the individual administrators of the three Odell Nursing Homes. Her duties included general oversight over the operations of the three homes, including preparation of budget, responsibility for the administration of employment and other contracts, managing accounts payable and receivable, compliance with applicable federal and state regulations and rules, and staffing issues.[11]

6. In November 1997, Ms. Blaze and Mr. Odell jointly purchased a home in Burnsville, Minnesota, and began living together as domestic partners.[12] They continued to live together in that home as domestic partners until November 2003 when they were married.[13]

7. Prior to 1997 and while still employed by Central Health Care Management, Ms. Blaze had also been doing some outside independent consulting work in the long-term care field.[14] On December 17, 1997, when Mr. Odell had begun

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[4] Tr. 939-40.
[5] After 1983, Frances Odell, Mr. Odell's mother, did have a consulting arrangement with the management companies that Mr. Odell subsequently established to operate the three facilities. Tr. 926
[6] Exhs. 13, 14, and 20.
[7] Tr. 992.
[8] Mr. Odell's nursing home management company appears to have been originally organized as Midwest Health Care Management, Inc. However, by about 1997 Mr. Odell had changed that name to Central Health Care Management, Inc. (Tr. 662-63.)
[9] Tr. 662.
[10] Tr. 991-92.
[11] Tr. 669.
[12] Tr. 807-08.
[13] Tr. 656.
[14] Tr. 663-65.

expressing interest in selling the Odell Nursing Homes, Ms. Blaze organized her own management company, Blaze & Phillips Consultants, Inc., ("Blaze & Phillips") to enable her to explore future options on her own.[15]

Mr. Odell's Initial Efforts to Sell the Odell Nursing Homes

8. In the mid- to late 1990s, Mr. Odell decided that he no longer wanted to be involved in the nursing home business and began looking for a buyer to purchase the Odell Nursing Homes.[16] During that period, Mr. Odell had contact with several organizations that expressed interest in purchasing the homes.[17]

9. One potential buyer was St. Francis Health Services of Morris ("St. Francis"), a nonprofit organization that owns and operates several nursing homes in Minnesota.[18] Luverne Hoffman is St. Francis' chief executive officer. In 1995 or 1996, Mr. Hoffman became involved in negotiations with Mr. Odell regarding purchase by St. Francis of the three Odell Nursing Homes.[19] Mr. Odell quoted Mr. Hoffman an asking price of approximately $9 million for the three facilities. Mr. Odell's asking price was based on calculations of the property rate income that St. Francis would be receiving from the Department after the sale.[20] But Mr. Hoffman was unwilling to consider a purchase in the range of Mr. Odell's asking price, and Mr. Hoffman discontinued further negotiations.[21] One reason why Mr. Hoffman considered Mr. Odell's asking price to be too high was that the property rate for the three facilities was insufficient to support that asking price.[22]

10. Since 1988, Bruce Farrington has been providing consulting services relating to the financial aspects of long-term care facilities, particularly in the area of purchase and sale of long-term care facilities.[23] In late 1996 or early 1997, Mr. Farrington organized a nonprofit corporation to operate long-term facilities in small Minnesota communities. Mr. Farrington subsequently had discussions with Mr. Odell about having that nonprofit corporation operate the three Odell Nursing Homes on a contract basis. They also discussed the possibility of the Odell Corporations selling the three Odell Nursing Homes to that nonprofit corporation. However, those discussions did not result in any management contracts or sales transactions.[24]

11. On or about April 28, 1997, there was a four-way meeting between Mr. Odell, Mr. Farrington, attorney Thomas Dougherty, and accountant Paul Fisher, the accountant for the Odell Corporations,[25] concerning issues raised by any sale by the

[15] Tr. 663-64.
[16] Tr. 954.
[17] Tr. 947-49, 1011-12.
[18] Tr. 1490-92.
[19] Tr. 949-51, 1495-1501.
[20] Tr. 1041-42.
[21] Tr. 1082-85, 1498-1500; Ex. 571.
[22] Tr. 1500, 1502.
[23] Tr. 337.
[24] Tr. 376-78.
[25] Tr. 1118.

Odell Corporations of their three nursing homes. One of the issues discussed was job security for Ms. Blaze in the event the nursing homes were sold.[26]

12. On May 20, 1997, Mr. Farrington provided Mr. Odell and his attorney, Tom Dougherty, with a Management Fee Study that detailed the management fees that were being charged to manage the operations of several long-term care facilities in Minnesota.[27]

13. On January 16, 1998, Mr. Farrington, through his consulting firm, Farrington Consulting, Inc., and Mr. Odell, through his management firm, Central Health Care Management, entered into a consulting agreement. In that agreement, Mr. Farrington agreed to assist Mr. Odell in managing the three Odell Nursing Homes, in refinancing of those facilities, and in their "eventual sale". [28] The parties also agreed as follows:

> In addition to the foregoing payments, CONSULTANT shall be paid 1% of the sales price at the date of closing on any sales of these three facilities during the next three years. Such payment shall be due even if the balance of this agreement is not in effect at the date of closing.[29]

14. Later in January 1998, Mr. Farrington helped Mr. Odell draft an employment agreement between Central Health Care Management, Mr. Odell's management company, and Curt Jenson, the administrator of the McIntosh nursing home, in which Mr. Odell agreed to work with Mr. Jenson to explore the possibility of Mr. Jenson acquiring the McIntosh home and to pay $30,000 to Mr. Jenson if that home were ever sold to someone else.[30]

15. Mr. Farrington continued to provide paid consulting services to Mr. Odell or the Odell Corporations until late February 1999.[31]

16. Thomas F. Dougherty is an attorney with the Minneapolis law firm of Lommen, Nelson, Cole, and Stageberg; his law practice primarily involves business and tax practice.[32] Mr. Dougherty had been providing legal services to Mr. Odell, the Odell Corporations, and Central Health Care Management since the early to mid 1990s.[33] During that period, Mr. Dougherty had been party to discussions and had provided legal advice to Mr. Odell concerning the sale of the Odell Nursing Homes to potential buyers.[34]

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[26] Exh. 574; Tr. 1074-75.
[27] Exhs. 31 and 503; Tr. 380-81.
[28] Tr. 378-79; Exh. 505.
[29] Exh. 505 at p. 2.
[30] Exh. 107; Tr. 372.
[31] *See* Findings 48 and 64, *infra*.
[32] Tr. 104.
[33] Tr. 184.
[34] Exh. 574; Tr. 1074-75.

17. Tom Hankes is a certified public accountant and a principal in the firm of Pilarski, Sinkel and Hankes.[35] Sometime in 1998, Mr. Farrington referred Mr. Odell to Mr. Hankes,[36] and in June 1998, Mr. Hankes began performing accounting services for Mr. Odell relating to a possible sale of the Odell Nursing Homes to another entity.[37] Ms. Blaze was present at all the meetings between Mr. Odell and Mr. Hankes concerning the financial affairs of Central Health Care Management and the Odell Corporations.[38]

18. In early 1998, Mr. Odell indicated to Mr. Jenson that he wanted to get out of the nursing home business and retire.[39] Thereafter, Mr. Jenson expressed interest to Mr. Odell about the possibility of purchasing McIntosh Manor from him.[40] On January 28, 1998, Mr. Jenson entered into a new employment agreement with Mr. Odell under which Mr. Odell agreed to explore the possibility of Mr. Jenson acquiring McIntosh Manor and also agreed to pay $30,000 to Mr. Jenson if that home was ever sold to someone else.[41] The agreement also provided that if a sale of McIntosh occurred before December 31, 1999, Mr. Jenson would receive the compensation that would otherwise have been due him from the date of the sale to December 31, 1999.[42]

19. In the late summer and fall of 1998, Mr. Odell began taking specific steps to create a nonprofit corporation to which he could sell the Odell Nursing Homes,[43] and Mr. Farrington and Mr. Hankes both began assisting him in establishing such a corporation.[44] By the fall of 1998, although a number of parties had expressed interest in buying one or more of the three facilities, Mr. Odell had not yet been able to find a suitable buyer.[45]

20. As early as August 1998, Ms. Blaze, Mr. Odell, and his attorney Thomas Dougherty began planning the creation of a nonprofit corporation to purchase the three facilities and how the homes would be managed after they were sold.[46]

Selection of the Foundation's Initial Board of Directors

21. In early October 1998, Mr. Farrington, acting on Mr. Odell's behalf and at his request, asked Ms. Blaze to be a member of the Foundation's initial three-member Board of Directors.[47]

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[35] Tr. 1111.
[36] Tr. 1137.
[37] Tr. 1114, 1136-37.
[38] Tr. 1139-40.
[39] Exh. 201 at p. 156.
[40] Exh. 202-1 at pp. 33-34.
[41] *See* Finding 14, *supra*; Tr. 372-73; Exhs. 107, 506.
[42] Exh. 202-1 at pp. 37-40; Exh. 107.
[43] Tr. 1141.
[44] Tr. 809-10, 1005.
[45] Tr. 366, 377, 947-50, 1015-16.
[46] Exhs. 572, 573.
[47] Tr. 682-83. It was Ms. Blaze's recollection that Mr. Farrington first approached her about being a member of the Foundation's Board, and that she did not discuss her Board membership with Mr. Odell

22. Sometime prior to October 15, 1998, Mr. Odell also asked Curt Jenson to be another member of the Foundation's initial three-member board of directors.[48] At the time of Mr. Odell asked him to be a Board member, Mr. Jenson was employed by Mr. Odell's management company, Central Health Care Management, as the administrator at McIntosh Manor,[49] and except for a brief time when he had managed another long-term care facility, Mr. Jenson had been employed in that capacity since 1989.[50] When Mr. Jenson became a Foundation Board member, Ms. Blaze was still his immediate supervisor, and she remained so until the sale of McIntosh Manor to the Foundation was closed.[51]

23. Sometime prior to October 15, 1998, Mr. Odell also asked Dr. Stephen Zuckerman to be the third member of the Foundation's initial three-member Board of Directors.[52] Prior to that time, Dr. Zuckerman had been a long-time acquaintance of Mr. Odell.[53] Dr. Zuckerman considered his role on the Board to be limited to general corporate oversight and planning, and after he came onto the Board, he did not actively involve himself with the Foundation's day-to-day operations or specific business transactions.[54]

Determination of Property Rates for Nursing Homes

24. The State of Minnesota pays nursing homes a daily rate for the care of residents served by the State's Medicaid program.[55] The system for determining the rates that the State, through the Department, pays for the care of Medicaid patients

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until after she had accepted Mr. Farrington's proposal. The implication of her testimony was that Mr. Odell had never considered the possibility of her Board membership or discussed it with her before Mr. Farrington came up with the idea. The ALJ does not believe that to be the case. It is inconsistent with other evidence in the record establishing that one of Mr. Odell's purposes in establishing the Foundation was to provide for ongoing gainful employment for Ms. Blaze after he retired, and that Mr. Odell, as the Foundation's major creditor, felt that his financial interests were being protected only while Ms. Blaze was managing the Foundation. *See* Findings 11, *supra*, and 95, *infra*. Moreover, the evidence clearly established that while engaging in pre-organization activities, Mr. Farrington was acting as Mr. Odell's agent. *See* Finding 21, *supra*. Ms. Blaze also testified that she had been discussing Board membership directly with Mr. Odell, (Tr. 811), and her testimony that Mr. Odell did not ask her to be on the Board is inconsistent both with prior statements she made and with Mr. Odell's testimony. Tr. 812-13, 960. In short, the ALJ finds that if it was Mr. Farrington who first asked Ms. Blaze to be a member of the Foundation's Board, he made that overture at Mr. Odell's request.

[48] Exh. 202-1 at pp. 50-54. Ms. Blaze contradicted Mr. Jenson and testified that it was she, and not Mr. Odell, who asked Mr. Jenson to serve on the Foundation's Board. (Tr. 685-86.) Given Ms. Blaze's personal interest in minimizing Mr. Odell's involvement in the pre-incorporation activities, the ALJ found Mr. Jenson to be the more reliable witness on this point.

[49] Exh. 201 at p. 170.

[50] Exh. 202-1 at p. 18.

[51] Tr. 395.

[52] Exh. 508.

[53] Tr. 595.

[54] Tr. 624.

[55] Nursing homes also have residents whose care is covered by the Medicare program and is paid for by the federal government, as well as some residents who use private resources to pay for their care. Any Medicare payments the Foundation has been receiving will be unaffected by this proceeding because they are governed by a completely different payment system.

is set forth in Minn. Stat. § 256B.431 and Minn. R. Ch. 9549, which together are commonly known and referred to by long-term care professionals as "Rule 50."[56]

25. McIntosh Manor, Crestview Care Center, and Pelican Lake Care Center are nursing homes that participate in the state's Medical Assistance program by providing care to Medicaid patients. The Department therefore has been setting their daily payment rates for those services under Rule 50.

26. Rule 50 provides for a daily rate for Medicaid patients made up of several components, one of which is a "property rate" that essentially reimburses the nursing home for the capital cost of its buildings.[57] Currently, Rule 50 generally allows the buyer of a nursing home to request the Department to recalculate the property rate immediately after the facility is sold to a new owner. When a nursing home is sold to a new owner, Rule 50 permits the Department to calculate a new property rate based on the purchase price paid by the buyer when that purchase price is financed entirely by debt. In other words, in those circumstances the Department uses the loan value to recalculate the property rate.[58] However, Rule 50 also provides for a limit or cap on the amount of the new property rate. In computing that property rate, the Department must disallow any portion of the mortgage loan cost that exceeds the Department's appraised value of the facility (the "DHS appraised value").[59]

27. Normally, a provider can only report capital expenditures that may affect the property once a year on the facility's annual cost report. But when there has been a sale of the facility, the buyer can submit documentation and ask the Department to recalculate the property any time during the cost year after the sale.[60] An exception to that general rule is that the Department will not recalculate a facility's property rate if the facility is sold to a "related organization."

28. Determining the DHS appraised value is complex. In the early 1980s, legislation required the Department to obtain appraisals of every nursing home in the state for the purposes of establishing the fair rental value of each facility.[61] The current DHS appraised value of a nursing home begins with that appraised value ("initial DHS appraised value"). The Department re-computes a nursing home's property rate annually, at a minimum by indexing the initial DHS appraised value forward with an annual inflation adjustment. Additionally, if a nursing home incurs an additional capital cost above a specified monetary threshold in a given rate year, it may report that capital cost in its annual cost report, and the Department adds that capital cost to the initial

[56] When making general references to the State's system for reimbursing nursing homes for the care of Medicaid patients and when referring to the testimony of witnesses that describes how that system operates, the ALJ may use the term "Rule 50" rather than referring to Minnesota Rules Chapter 9549 or a provision of Minn. Stat. § 256B.431. However, when drawing conclusion about specific applications of the law to the facts in this report, the ALJ will refer to specific statutes and rules by number.
[57] Tr. 414-15.
[58] Tr. 435. This is at least in the case of sales where there is no down payment, and the amount of the loan is equal to the purchase price. The expert witnesses did not address any other scenario.
[59] *Id.*; Tr. 1237-46.
[60] Tr. 416-17, 425.
[61] Tr. 437.

DHS appraised value of the facility when computing the annual property rate. Capital costs that are reported and allowed in subsequent rate years are also indexed forward from the time they were incurred to the date of the sale.[62]

29. However, in a given rate year, a nursing home may also incur capital costs that do not meet the specified monetary threshold. Those costs are not immediately reportable and are not added to the facility's ongoing annual property rate calculation. However, Rule 50 does allow those previously unreported, historical capital costs to be recognized and added to the DHS appraised value when the facility is sold. As a result, the DHS appraised value can increase as of the date of sale, and the effect of that increase will be to allow the buyer to cover more of the mortgage loan cost in the property rate than the pre-sale property rate would have allowed.[63] A property rate increase that the Department computes for a buyer after a sale of a nursing home is often called a "bump up" or "step up."[64]

30. Because of the way applicable statutes and rules prescribe calculation of nursing home property rates, a facility's independently appraised fair market value at the time of sale has no impact on property rates, including those calculated following a sale.[65]

Determination by Mr. Odell of the Sales Prices of the Odell Nursing Homes

31. In September 1998, Mr. Hankes met with Mr. Odell and Ms. Blaze to discuss the financial benefits of selling the Odell Nursing Homes to a nonprofit corporation. During that discussion, Mr. Odell indicated to Mr. Hankes that the sales would be seller-financed—that is, by promissory notes for the entire amounts of the purchase prices issued by the purchasing nonprofit corporation to the three Odell Corporations. Mr. Odell also told Mr. Hankes that one of the objectives in structuring such sales was to obtain the highest possible increase in the Department's property rates for the three facilities following the sales in order to maximize the sales prices for the Odell Corporations.[66]

32. At the initial or some subsequent meeting with Mr. Hankes, Mr. Odell requested Mr. Hankes to put together financial scenarios for establishing sale prices for the three Odell Nursing Homes. Ms. Blaze was present at that meeting, and Mr. Hankes understood that he should work together with Ms. Blaze in developing those financial scenarios.[67]

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[62] Tr. 416-40, 1237-46. If a nursing home was previously sold, computation of the property rate is somewhat simpler. The previous sale price becomes the new base appraised value for subsequently indexing the property rate forward. But here, the evidence established that the three Odell Nursing Homes had never previously been sold.
[63] *Id*.
[64] Tr. 329, 420-21, 1397-98.
[65] Tr. 438-39, 1183-84.
[66] Tr. 1138-42.
[67] Tr. 1137-38; 1147-48.

33. Thereafter, Mr. Hankes provided Mr. Odell with financial scenarios that would meet Mr. Odell's objectives, and those financial scenarios included estimates of the increases (or "step-ups") in the Department's property rates for the three facilities that would occur as a result of sales.[68] Mr. Hankes' estimate of the stepped-up property rate for Crestview Manor was $10.837 per patient day, for Pelican Lake Health Center $10.874 per patient day, and for McIntosh Manor $10.669 per patient day.[69] Ms. Blaze was present when Mr. Hankes provided Mr. Odell with the stepped-up property rate estimates for the three facilities.[70]

34. At the time Mr. Hankes provided his stepped-up property rate estimates to Mr. Odell, Mr. Hankes was unaware that his estimates would be used to support appraisals of the Odell Nursing Homes.[71]

35. It was Mr. Odell's view that he did not need to have the Odell Nursing Homes appraised prior to a sale because he already knew what they were worth.[72] But sometime after receiving Mr. Hankes' stepped-up property rate estimates for the three facilities but before December 3, 1998, Mr. Odell engaged Joe T. Tisdell of Tisdell Appraisal Services, Inc., to appraise Crestview Manor and Pelican Lake Health Center. Mr. Odell needed appraisals for Home Savings Bank, the Odell Corporations' mortgagee.[73] Mr. Tisdell did not prepare an appraisal of McIntosh Manor until March 22, 1999, nearly two months after the sale of that facility to the Foundation.[74]

36. It is a common practice for potential sellers and buyers of nursing homes to consult with the Department prior to sales for the purpose of determining what documentation the Department will need to calculate a new property rate after the sales and to determine whether there might be any possible property rate issues connected with the proposed sales.[75]

37. During the period from about November 1998 through June 1999, Ms. Blaze had several discussions with Patrick Betz, the Department's Audit Supervisor, concerning the property rate that the Department would be paying to the Foundation after the sales of the three facilities had been completed. Ms. Blaze's first contact with Mr. Betz was by telephone in November 1998. Ms. Blaze indicated to Mr. Betz that a proposal was being developed to sell the three Odell Nursing Homes to a nonprofit corporation being formed by local people for the purpose of keeping the facilities locally owned.[76] Ms. Blaze identified herself to Mr. Betz as an independent contractor who had been hired to help facilitate the sale and the changeover of the

[68] Tr. 1142.
[69] Tr. 1144-46; Exh. 27 at p. 23; Exh. 28 at p. 23; Exh. 29 at p. 23, respectively.
[70] Tr. 1139-40.
[71] Tr. 1144-46.
[72] Tr. 1006.
[73] *Id.*; Exh. 27 at p. 3; Exh. 28 at p. 3; Exh. 29 at p. 3.
[74] Exh. 29 at p. 3. Mr. Tisdell apparently inspected that facility on April 23, 1998, nearly ten months before that facility was sold to the Foundation, but there is no evidence in the record that Mr. Tisdell actually prepared an appraisal for McIntosh Manor before that facility was sold to the Foundation.
[75] Tr. 507.
[76] Tr. 505.

ownership. [77] She did not specifically tell Mr. Betz then that she was a prospective Board member and officer of the Foundation, and Mr. Betz was uncertain about which of the parties she was representing at that time.[78] Since there had never been a previous sale of the Odell Nursing Homes, Mr. Betz informed Ms. Blaze about the kind of historical capital expenditure information that the Department would need in order to recalculate a new, post-sale property rate.[79]

38. During her telephone conversation with Mr. Betz in November 1998, Ms. Blaze did not provide him with any information about the proposed sales prices for the three facilities that Mr. Odell had established for Mr. Dougherty in early October that were, in turn, based on the estimated property rate calculations that Mr. Hankes had developed in September 1998.[80] Ms. Blaze also did not then inform Mr. Betz that Mr. Hankes had already made some estimated property rate calculations or that she possessed such information. Ms. Blaze did not provide Mr. Betz with Mr. Hankes' estimates of the new property rates until mid or late January 1999, after the sales of Crestview Manor and Pelican Lake Care Center had been completed.[81]

39. During Ms. Blaze's initial telephone conversation with Mr. Betz in November 1998, she asked about formulas and mathematical calculations the Department used to calculate property rates and what documentation the Department would need to recalculate the property rate payable to the facilities after they had been acquired by the Foundation.[82] In response, Mr. Betz faxed her a copy of the spreadsheet that the Department used to calculate property rates and told her to call him if she had any questions about how to use the spreadsheet.[83]

40. Sometime prior to December 3, 1998, either Mr. Odell or Ms. Blaze provided Mr. Tisdell with Mr. Hankes' earlier estimates of the stepped-up property rates that the three Odell Nursing Homes would receive after they were acquired by the Foundation.[84] In determining his income approaches to valuing each facility, Mr. Tisdell relied solely on the stepped-up property rates that Mr. Hankes had previously estimated for the three facilities.[85]

41. Mr. Odell based the asking prices for the sales of the three Odell Nursing Homes to the Foundation solely on the stepped-up property rates that Mr.

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[77] Tr. 504.
[78] Tr. 503-05, 508, 704-07. The testimony of Ms. Blaze and Mr. Betz differed about whether Ms. Blaze's initial contact with Mr. Betz was by telephone or in person and about how Ms. Blaze identified herself during that discussion. Since Ms. Blaze's recollection about how the discussion occurred was more detailed than Mr. Betz', the ALJ found that their first contact was by telephone.
[79] Tr. 503-07.
[80] Tr. 503.
[81] Tr. 508, 510; 707-08.
[82] Tr. 503-07, 705-06.
[83] Tr. 705-06.
[84] Mr. Hankes testified that he had no prior knowledge of the Tisdell appraisals prior to the hearing. (Tr. 1144-46.)
[85] Tr. 1146; Exh. 27 at p. 22; Exh. 28 at p. 22; Exh. 29 at p. 22.

Hankes had previously estimated for the three facilities, and not on Mr. Tisdell's appraisals.[86]

Formation of the Foundation

42. Sometime in early October 1998, Mr. Odell asked Mr. Dougherty, to prepare drafts of the corporate documents needed to form the Foundation, as well the asset purchase agreements and other documents required for sales of the three Odell Nursing Homes from the Odell Corporations to the Foundation.[87]

43. By October 15, 1998, Mr. Dougherty had prepared the draft formation documents that Mr. Odell had requested him to prepare, and on that date Mr. Dougherty transmitted them to Mr. Odell, Ms. Blaze, Mr. Jenson, and Dr. Zuckerman for their review and comment.[88] By the same letter, Mr. Dougherty also transmitted to those same persons drafts of asset purchase agreements detailing the terms under which the Foundation would be purchasing the three Odell Nursing Homes from the Odell Corporations.[89] The purchase prices set forth in those draft agreements were based on what Mr. Hankes had earlier estimated that the property rates of the facilities would be after the sales.[90]

44. By other correspondence dated October 15, 1998, Mr. Dougherty advised Mr. Odell, Ms. Blaze, Mr. Jenson, and Dr. Zuckerman that he was representing the Foundation only for the limited purpose of forming the corporation and obtaining § 501(c)(3) status for it from the Internal Revenue Service. He disclosed that he had been and would continue to represent Mr. Odell and the Odell Corporation in connection with the sale of the Odell Nursing Homes to the Foundation.[91]

45. On December 1, 1998, Ms. Blaze, as incorporator, executed the Foundation's Articles of Incorporation, and they were filed with the Secretary of State on the same day.[92] By written action of the same date, Ms. Blaze, again as sole incorporator, elected the three member Board of directors that Mr. Odell had previously recruited for the Foundation—namely, herself, Mr. Jenson, and Dr. Zuckerman.[93]

46. By written action also on December 1, 1998, Ms. Blaze, Mr. Jenson, and Dr. Zuckerman, as first directors, adopted the Foundation's By-Laws,[94] and by written action confirmed the election of the Foundation's initial officers, namely; Ms. Blaze was elected President and Treasurer; Mr. Jenson was elected Vice President,

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[86] *Compare* Exh. 27 at pp. 23-24 *with* Exh. 13, Tab 1, at p. 2; *compare* Exh. 28 at pp. 23-24 with Exh. 14, Tab 1, p. 2; *compare* Exh. 29 at pp. 23-25 with Exh. 20, Tab 1, p. 2.
[87] Exh. 573; Tr. 107-08.
[88] Exh. 509.
[89] *Id*.
[90] *Id*.; Finding 33, *supra*.
[91] Exh. 509; Tr. 108-10.
[92] Exh. 557.
[93] Exh. 559.
[94] Exh. 549, 558.

and Dr. Zuckerman was elected Secretary.[95] That slate of officers was provided to Mr. Dougherty by Mr. Odell, and not by any member of the Board.[96]

47. The Foundation was organized without significant start-up capital,[97] and none of the initial three directors of the Foundation had a personal financial investment in the corporation.[98]

48. Mr. Odell, either personally or through his corporations, paid all of the fees and expenses owed to Messrs. Farrington, Hankes, and Dougherty relating to the formation and initial business transactions of the Foundation. Subsequently, Mr. Odell neither sought nor obtained reimbursement from the Foundation for the costs he incurred in connection with the formation of that corporation.[99]

49. Mr. Dougherty sent Mr. Odell copies of all correspondence and other work-product he prepared in connection with formation of the Foundation, including drafts of the Foundation's by-laws, articles of incorporation, and its application for tax-exempt status.[100] He also sought Mr. Odell's comments on those documents before they were completed, but he did not seek Mr. Odell's approval of the documents.[101]

Board Approval of the Purchases of Crestview Manor and Pelican Lake Care Center

50. On December 7, 1998, attorney Thomas Dougherty forwarded a number of documents for the Board's review, approval, and signature. Among those documents was a Written Action of the Directors dated December 7, 1998.[102]

51. By written action dated December 7, 1998,[103] Ms. Blaze, Mr. Jenson, and Dr. Zuckerman approved a number of Board resolutions. The first resolution recited that all the Board members had opportunities to examine and analyze the Asset Purchase Agreements that Mr. Dougherty had prepared for the Odell Corporations relating to the sales of Crestview Manor and Pelican Lake Care Center to the Foundation.[104] Like the draft Asset Purchase Agreement that Mr. Dougherty had sent to them on October 15, 1998,[105] the purchase price for Crestview Manor was $2,573,460.00, and the purchase price for Pelican Lake Care Center was

[95] Exh. 549.
[96] Exh. 202-1 at pp. 48-50; Exh. 201 at pp. 165-66; *see* Part IV-B of the Memorandum that follows.
[97] Ex. 11 at p. 9.
[98] Tr. 600, 634.
[99] Tr. 844-45, 998-1001, 1006.
[100] Exhs. 509, 510, 511, 512. The Foundation waived the attorney-client privilege so that Mr. Dougherty could testify at the hearing regarding the legal services he performed for the Foundation under this engagement. Tr. 110.
[101] Tr. 124; Ex. 509.
[102] Exh. 12.
[103] *Id*.
[104] Exh. 13, Tab 1, and Exh. 14, Tab 1.
[105] Exh. 509.

$2,646,540.00. In fact, Mr. Odell had instructed Mr. Dougherty to use the property rate estimates developed earlier by Mr. Hankes to establish the sale prices.[106] However, unlike the draft agreement provided to them in October, the interest rate payable by the Foundation was 10%, as opposed to the earlier rate of 9%.[107] There were no face-to-face discussions among Board members regarding that change to the Asset Purchase Agreements before they signed the written action on December 1, 1998, approving them and empowering Ms. Blaze to execute them on the Foundation's behalf.[108]

52. Again, acting on behalf of the Odell Corporations Mr. Dougherty subsequently drafted an Asset Purchase Agreement for the sale of McIntosh Manor to the Foundation. The purchase price for that facility was $3,200,000.00, with the same terms and conditions the same as in the earlier two Asset Purchase Agreements that had been considered by the Board.[109]

53. The three sales involved wrap-around seller financing. In wrap-around financing, the seller remains obligated to pay off the underlying debt in accordance with the terms of the seller's note and mortgage.[110] The essential terms of the Asset Purchase Agreements were: There were to be no down payments and the Foundation was to execute purchase money promissory notes payable to the selling Odell Corporations in the full amount of the purchase prices and secured by purchase money mortgages; interest only at the rate of 10% per annum for three years; and interest and principal amortized over fifteen years with a balloon payment six years from the date of closing.[111]

54. The purchase agreements also provided for the Foundation to assume most of the selling corporation's liabilities,[112] that the Foundation's payments to Mr. Odell would begin during the same month the sales were consummated, and that if the Foundation defaulted in its payments, the Odell Corporations would have the right to foreclose on the purchase money mortgages.[113]

55. On December 9, 1998, Mr. Dougherty wrote a letter on Mr. Odell's behalf to Home Federal Savings Bank, who held the underlying mortgages for the three nursing homes, seeking to have the bank consent to waive the due clauses of its mortgages on the nursing homes so that Mr. Odell could continue to maintain those mortgages after he sold to the Foundation.[114] Mr. Dougherty sent a copy of the letter to Ms. Blaze, and the bank was invited to contact Ms. Blaze for information about Mr.

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[106] Tr. 193-94.
[107] *Compare* Exh. 509 *with* Exh. 13, Tab 1, pp. 2-3, and Exh. 14, Tab 1, pp. 2-3.
[108] Exh. 202-1 at pp. 55-57.
[109] Exh. 20, Tab 1.
[110] Tr. 150; Exhs. 13, 14, 20.
[111] Exh. 13, Tab 1; Exh. 14, Tab 1; Exh. 513. The wrap-around mortgages and sales transactions were approved by Home Federal, the lending institution that loaned secured financing to the Odell Corporations. (Exhs. 10, 18, 48.)
[112] Exhs. 13, 14, 20 at Tab 1, paragraph 3.2.
[113] Exhs. 13, 14, 20.
[114] Exh. 10.

Odell's loans.[115] By letter dated January 11, 1999, Home Savings Bank gave its consent to the sales.[116]

56. The first Board resolution by written action on December 7, 1998, authorized Ms. Blaze to execute on behalf of the Foundation the Asset Purchase Agreements relating to the sales of Crestview Manor and Pelican Lake Care Center, as set forth in the asset purchase agreements, and to complete any related transactions necessary to consummate the two sales.

57. By a Board resolution by written action on February 1, 1999, the Board authorized Ms. Blaze to execute on behalf of the Foundation the Asset Purchase Agreement relating to the sale of McIntosh Manor, as set forth in the asset purchase agreement drafted by Mr. Dougherty, and to complete any related transactions necessary to consummate the two sales.[117] As was the case with authorization of the Crestview Manor and Pelican Lake Health Center purchase agreements, there were no face-to-face discussions among Board members regarding the terms of that Asset Purchase Agreement before Board members signed it.

58. Before they approved the sales, the Foundation's directors never discussed deviating from the sales prices and terms that Mr. Odell originally proposed. None of them made independent inquiries into whether the terms of those sales would be financially viable for the Foundation, such as independent appraisals of the homes, independent financial analyses of the sales terms or of their financial implications for the Foundation, or other independent advice.[118]

59. Potential buyers of nursing homes commonly consider such things as the physical condition of the facility, occupancy levels, and operating expenses in determining whether to proceed with a purchase.[119] No formal Board meeting was convened before the directors authorized the purchase of the Odell Nursing Homes. The Foundation's directors as a body never discussed any of those factors or any others before agreeing to the sales that Mr. Odell had proposed. In fact, there was no discussion at all about the proposed sales in a formal Board meeting.[120] It is uncommon for the directors of a new corporation, such as the Foundation, to authorize the consummation of an $8.4 million transaction without ever having met and talked to each other face-to-face.[121]

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[115] Tr. 198-200; Exh. 513.
[116] Exh. 18.
[117] Exh. 550.
[118] Exh. 201 at pp.168-69; Tr. 173-75, 844-45. In fact, Dr. Zuckerman's erroneously believed that Ms. Blaze had engaged an independent consultant to provide the Foundation with an opinion about the sales prices. (Tr. 632-33.)
[119] Tr. 1505-06.
[120] The first face-to-face meeting of the Board was on February 4, 1999, (Tr. 812) after Ms. Blaze had executed all three Asset Sales Agreements on behalf of the corporation. Moreover, there was not even discussion of the sales after the fact at that February 4, 1999, Board meeting. (Exh. 544.)
[121] Tr. 214-15.

60. On December 7, 1998, Ms. Blaze, acting on authority of the Board's earlier written action, and Mr. Odell, acting on behalf of the two pertinent Odell Corporations, executed Asset Purchase Agreements relating to Crestview Manor and Pelican Lake Care Center incorporating the prices, terms, and conditions set forth in Findings 53 and 54, above.

§ 501(c)(3) Status, Tax Exempt Bonds, and Expansion of the Board

61. On December 8, 1998, Mr. Dougherty submitted an application to the Internal Revenue Service on the Foundation's behalf requesting recognition that the Foundation qualified as tax-exempt under § 501(c)(3) of the Internal Revenue Code.[122]

62. During January 1999, Messrs. Dougherty and Farrington met with bond counsel regarding obtaining tax-exempt bond financing for the Foundation. Based on those discussions, Mr. Dougherty made recommendations to Ms. Blaze, Mr. Jenson, and Dr. Zuckerman for changes to the Foundation's Management Agreement with Blaze & Phillips that would place it within an IRS safe harbor ruling allowing the possibility of tax-exempt bond financing.[123] Those recommendations included eliminating a fixed monthly fee of $76.00 per patient bed and reducing the monthly fee of total resident care revenue payable to Blaze & Phillips from 3% to 0.5%.[124]

63. On January 30, 1999, the IRS notified Mr. Dougherty that it had defined the Management Agreement between the Foundation and Blaze & Phillips as "related" because Ms. Blaze was a principle in both corporations and requested further information before recognizing and qualifying the Foundation as tax-exempt under § 501(c)(3).[125]

64. Sometime in February 1999, Mr. Dougherty determined that it would be helpful to submit to the IRS an independent opinion about the fairness of the Blaze & Phillips management agreement for the purpose of supporting the Foundation's § 501(c)(3) status application, and he engaged Mr. Farrington to provide him with that fairness opinion.[126] On February 23, 1999, Mr. Farrington sent a letter to the Foundation Board in which he expressed the opinion that the Blaze & Phillips management agreement was "a fair and equitable fee for the services provided by [Blaze & Phillips] and within the acceptable range of such fees."[127] Mr. Dougherty subsequently forwarded that letter to the IRS.[128] Mr. Odell's management company, Central Health Care Management paid Mr. Farrington for that service.[129] As a basis for his opinion, Mr. Farrington relied on the management fee study that he had prepared for

[122] Exh 11.
[123] Exh. 518.
[124] *Id*.
[125] Exh. 519.
[126] Tr. 164-65, 339-41.
[127] Exh. 33.
[128] Tr. 165.
[129] Tr. 343-44.

Mr. Odell in May 1997 and that he had provided to Ms. Blaze when he assisted her in drafting the Blaze & Phillips management agreement with the Foundation.[130]

65. One of the goals Mr. Dougherty was asked to pursue was to obtain subsequent authority for the Foundation to issue tax-exempt bonds to the Odell Corporations in lieu of the promissory notes described in the Asset Sales Agreements.[131] In order to obtain authorization for that, it was necessary for the Foundation to have a five-member, rather than a three-member, Board of directors. Sometime in January 1999, Tom Dougherty advised the Board that it needed two more members to ensure that the Foundation would satisfy IRS requirements for tax-exempt financing, which was contemplated for the future to replace the seller financing by Mr. Odell.[132] Rather than the Foundation's three existing directors, it was Mr. Odell who subsequently recruited James Green and Alan Borg to be the fourth and fifth directors.[133]

66. Sometime prior to February 4, 1999, the original three directors elected James Green to the Foundation's Board,[134] and by written action dated February 11, 1999, the original three directors elected Alan Borg to the Foundation's Board.[135]

67. By letter issued on March 25, 1999, the Internal Revenue Service issued an advance ruling giving the Foundation provisional recognition as having tax-exempt status under § 501(c)(3). During the times relevant to this proceeding, the Foundation did not issue tax-exempt bonds.

Board Approval of a Management Agreement with Blaze & Phillips

68. When Mr. Odell began efforts to organize the Foundation in the fall of 1998, both he and Ms. Blaze expected that the three Odell Nursing Homes would be managed after the sale by Blaze & Phillips Consultants, Inc., the corporation that Ms. Blaze had formed in 1997 because, among other things, Mr. Odell wanted to structure the transactions in a way that provided job security for Ms. Blaze.[136] At Mr. Odell's request, Mr. Farrington asked Ms. Blaze to submit a management contract to the Foundation's Board for Blaze & Phillips to manage the three Odell Nursing Homes after the sale.[137] Mr. Farrington then assisted Ms. Blaze in developing that proposal, and in

[130] Tr. 344-45; *see* Finding 12, *supra*, and 68, *infra*.
[131] Exh. 513.
[132] Tr. 132-33, 151.
[133] Tr. 815-16, 1006-09.
[134] There is no evidence in the record establishing exactly when James Green was elected to the Board. However, it appears that Mr. Green was not a Board member on January 19, 1998, (Exh. 518) but was a Board member on February 4, 1999. (Exh. 520).
[135] Exh. 551; Tr. 816-17. Ms. Blaze testified that she talked to him about being on the Board (Tr. 688-89.) but conceded that it was Mr. Odell who had specifically asked Mr. Borg to serve on the Board. (Tr. 816.)
[136] Exhibit 201 at pp. 181-85; Exh. 574.
[137] Ms. Blaze conceded that it was possible that it was Mr. Odell who asked her to develop a proposal to have Blaze & Phillips manage the three nursing homes for the Foundation after the sale, but that she only specifically recalled discussing that with Mr. Farrington. The ALJ therefore found that if it was Mr.

so doing, he provided her with the Management Fee Study that he had provided to Mr. Odell on May 20, 1997.[138]

69. At all times relevant to this proceeding, Mr. Odell operated Blaze & Phillips out of the Burnsville home she shared with Mr. Odell.[139]

70. Another of the documents that Mr. Dougherty sent to Ms. Blaze, Mr. Jenson, and Dr. Zuckerman on December 7, 1998, was the proposed Management Agreement between the Foundation and Blaze & Phillips Consultants, Inc., that Mr. Farrington and Ms. Blaze had developed.[140]

71. Mr. Odell had a role in selecting Blaze & Phillips to manage the three homes after they were sold to the Foundation.[141]

72. The original Management Agreement proposed by Ms. Blaze on behalf of Blaze & Phillips called for compensation payable by the Foundation to be a fixed monthly payment of $76.00 per patient bed and another monthly fee of 3% of total resident care revenue.[142]

73. The third resolution that the Foundation Board members had approved by written action on December 7, 1998, authorized Dr. Zuckerman to enter into the contracts "in the form herewith presented" for the management of Crestview Manor and Pelican Lake Care Center.[143] The only management contracts presented for the Board's review and consideration were management contracts between the Foundation and Blaze & Phillips.[144]

74. On February 1, 1999, the Foundation Board approved a resolution by written action authorizing Dr. Zuckerman to enter into the contracts "in the form herewith presented" for the management of McIntosh Manor.[145]

75. On February 4, 1999, at a regular Board meeting in Alexandria, Minnesota,[146] the Foundation's Board approved Management Agreements for Blaze & Phillips to manage all three Odell Nursing Homes, which the Foundation had by then acquired. Those agreements provided for compensation payable by the Foundation in the amount of $76.00 per licensed patient bed, together with an additional monthly fee

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Farrington who asked Ms. Blaze to submit a proposal for Blaze & Phillips to manage the facilities, he did so at Mr. Odell's request. (*See* n. 41, *supra*.)

[138] Tr. 827-28; *see also* Finding 12.

[139] Tr. 823.

[140] Exh. 512.

[141] Tr. 1025.

[142] *See* attachment to Exh. 518.

[143] Exh. 12.

[144] Exh. 201 at p. 183; Exh. 202-1 at p. 149.

[145] Exh. 550.

[146] Tr. 698; Exh 544.

of 0.5% of total resident care revenue, as had been recommended by Mr. Dougherty on January 19, 1999.[147]

76. Sometime after February 4, 1999, Dr. Zuckerman, acting on behalf of the Foundation, entered into Management Agreements for Blaze & Phillips to manage all three Odell Nursing Homes on the terms approved by the Board on February 4, 1999. The Management Agreements covering Crestview Manor and Pelican Lake Care Center were backdated to be effective as of January 1, 1999, and the Management Agreements covering McIntosh Manor were backdated to be effective as of February. 1, 1999.[148]

Sale of Nursing Homes to the Foundation

77. On January 12, 1999, the sales of Crestview Manor and Pelican Lake Care Center were closed in accordance with the terms of the earlier Asset Sales Agreements that Ms. Blaze had executed on behalf of the Foundation and Mr. Odell on behalf of Crestview Manor, Inc., and Pelican Lake Care Center, Inc. Both had a retroactive effective date of January 1, 1999.[149]

78. On February 19, 1999, the sale of McIntosh Manor was closed in accordance with the terms of the earlier Asset Sales Agreement that Ms. Blaze had executed on behalf of the Foundation and Mr. Odell on behalf of McIntosh Manor, Inc. It had a retroactive effective date of February 1, 1999.[150]

79. The aggregate purchase price payable by the Foundation to the Odell Corporations was approximately $8.4 million. That entire purchase price was payable by the Foundation pursuant to purchase money promissory notes given to each of the Odell Corporations, and those notes were secured by purchase money mortgages held by those corporations on each of the three facilities.[151] At the time of the sales, the balance that the Odell Corporations owed on their underlying debt to Home Savings Bank was about $3.1 million.[152]

Post-Sale Discussions with Patrick Betz

80. On January 27, 1999, after the sales of Crestview Manor and Pelican Lake Care Center had been completed, Ms. Blaze met in person with Mr. Betz at the Department. She brought with her the executed Asset Sales Agreements between the Odell Corporations and the Foundation for Crestview Manor and Pelican Lake Care Center, as well as the proposed Asset Sales Agreement for McIntosh Manor. She also brought copies of Mr. Hankes' estimates of the increases in the Department's property rates for the three facilities that would occur as a result of sales.[153] At the time

[147] Exh. 518.
[148] Exhs. 553, 554, and 554.
[149] Exhs. 13, 14.
[150] Exh. 20.
[151] Exhs. 13, 14, and 20.
[152] Tr. 1051-52.
[153] Tr. 509-13, 707-10.

of that meeting, Mr. Betz was unaware that two of the Odell Nursing Homes had already been sold to the Foundation.[154]

81. During the January 27, 1999, meeting, Mr. Betz examined Mr. Hankes' estimates of the post-sale property rates and concluded that all of Mr. Hankes' estimates of the post-sale property rates were incorrect.[155] Upon sale of a nursing home, the new property rate is based on the sale price, which in the case of the sales of the Odell Nursing Homes to the Foundation was equal to loan values reflected in the purchase money promissory notes that the Foundation gave to the Odell Corporations.[156] However, the DHS appraised value operates as a cap on the loan value in transactions such as these, and for property rate purposes, the Department disallows any portion of the loan value that exceeds the DHS appraised value.[157] It was Mr. Betz' conclusion that the available documentation establishing the historical costs of the Odell Nursing Homes, indexed forward to the date of the sales, established DHS appraised values that were lower than the loan values that the Asset Purchase Agreements had established for the three facilities. Based on that, it was Mr. Betz' conclusion that the prices that the Foundation was paying for the three facilities were too high, and the new, stepped-up property rates would be insufficient to service the debt that the Foundation had obligated itself to pay to the Odell Corporations.[158] Following the meeting, Mr. Betz did indicate to Ms. Blaze in writing that a sale of the three Odell Nursing Homes would cause some increase in their property rate but that it was impossible for him to determine at that time what the increase would be.[159]

82. If the Foundation was unable to obtain a stepped-up property rate from the Department, the Foundation had no other way of obtaining the revenue necessary to service the debt that it owed to the Odell Corporations.[160]

83. After Mr. Betz shared his conclusion with Ms. Blaze that what could then be documented to establish new property rates would be insufficient to service the Foundation's debt, he suggested some possible approaches to her that might correct the problem in subsequent discussions with her.[161] Mr. Betz' first suggestion was to search for additional documentation of historical costs to establish capital expenditures made by the three facilities in the past, which, if indexed forward, would result in increases in their property rates that would be sufficient to cover the loan values.

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[154] Tr. 510.
[155] Tr. 509-10.
[156] In other words, in connection with the transactions at issue here, the sales prices equaled the loan values because 100% of the sales prices were being owner-financed by the Odell Corporations, and the loan value was therefore an accurate reflection of the sales prices.
[157] Tr. 1205; s*ee also* Finding 26, *supra*.
[158] Tr. 510, 708.
[159] Exh. 60.
[160] Exh. 200 at pp. 40, 51.
[161] Tr. 456-65, 509-13, 707-10, 714-15, 721.

84. Following their January 27, 1999, meeting, Ms. Blaze worked with Mr. Betz[162] to continue the search for documentation of the historical costs of the assets to ensure that the allowable debt limit established by Minn. Stat. § 256B.431, subd. 14 reflected all asset purchases.[163] However, because of the length of time the three facilities had been owned by the Odell family, neither the Department nor the Odell Corporations were able to find additional documentation for the historical cost of all asset purchases.[164]

85. Second, Mr. Betz suggested that the Foundation wait until Medicare recognized the sales, because Minnesota statutes required the Department to follow Medicare's lead on capital assets.[165] But Ms. Blaze concluded that it would take Medicare 18 to 24 months to recognize the sale, which the Foundation considered to be an unacceptably long period of time.[166] Additionally, the federal government changed its Medicare reimbursement formula and although Medicare never rejected the reported sales, Medicare had no reason to rely on their loan values.[167]

86. At the time of Mr. Betz' ongoing discussions with Ms. Blaze in the spring of 1999, the Minnesota Legislature was in session. Mr. Betz' third suggestion was for the Foundation to obtain special legislation establishing the Foundation's property rates by law, notwithstanding any of the provisions in Rule 50.[168] In response, Ms. Blaze and Mr. Jenson requested a member of the State House of Representatives to introduce a bill to that effect.[169] On or about March 17, 1999, the House member whom Ms. Blaze and Mr. Jenson had contacted introduced House File 2082, which provided that in calculating the property rates for three Odell facilities, the Department must "recognize the purchase price of the facilities as the allowable appraised value, allowable debt, and the maximum replacement cost new."[170] The bill received a hearing before a House committee, at which Ms. Blaze, Mr. Jenson, and Mr. Hankes testified in favor of the bill,[171] but the Legislature did not pass the bill.[172]

87. The fourth suggestion that Mr. Betz made to Ms. Blaze was to restructure the sales transactions[173] by reducing the sale prices to an amount at or below what the Department was able to establish with existing documentation as the DHS appraised value and by increasing the interest rates of the purchase money loans in a way that cash flow would remain the same for both parties—i.e., dollar amounts of

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[162] Pat Betz met routinely with buyers of nursing homes to provide assistance and advice regarding what impact a sales transaction would have on the related property rate set by the Department.
[163] Tr. 470-71, 505-06, 510-17.
[164] *Id*.
[165] Tr. 512-13.
[166] Tr. 711.
[167] Tr. 306-310, 457.
[168] Tr. 458-59.
[169] Tr. 712-14; Exh. 202-1 at pp. 64-66.
[170] Exh. 59.
[171] Tr. 712-14; Exh. 202-1 at pp. 64-66.
[172] Tr. 458-59, 717.
[173] The earlier sales documents had never been formally submitted to the Department for the purpose of recalculating the property rate. (Tr. 708.)

payments made by the Foundation and received by the Odell Corporations.[174] By lowering the purchase prices to an amount equal to the DHS appraised values of the three facilities, the Department would recognize the full amounts of the loan values when computing the property rates. Additionally, increasing the interest rates would result in dollar-for-dollar increases for the interest expense component of the property rates. The result would be higher property rate payments than the Department would have allowed under the original sales prices and terms of the sales.[175]

Other Post-Sale Transactions

88. On December 17, 1998, when the Odell Nursing Homes were still owned by the Odell Corporations and managed by Central Health Care Management, the premium came due for automobile insurance on certain vehicles owned by the facilities and operated by them, as well as some operated by Mr. Odell and other principals in the Odell Corporations. The policy was for the premium year 11/30/98 to 11/30/99. Central Health Care Management made the first installment on December 8, 1998. When the facilities were sold, the Foundation kept that policy in force and paid the subsequent installments due during the policy year.[176] It was the intent of the Foundation's certified public accountant to settle up and allocate accounts between the Foundation and the Odell Corporations after he received the calendar year-end audited financial statements for the Odell Corporations from their accountant. That settlement and allocation of the automobile insurance premium account never occurred because the Foundation terminated the services and hired another accounting firm in the summer of 1999 before the Odell Corporations' year-end financial statements became available, and the new accounting firm did not follow through with the settlement of the automobile insurance account.[177]

89. On or about January 1, 1999, the Foundation engaged Mr. Hankes to be its certified public accountant. That engagement ended on August 12, 1999.[178]

90. When the Odell Corporations sold the three nursing homes to the Foundation on January 1 and February 1, 1999, the Odell Corporations owed deferred management fees to Central Health Care Management in the aggregate amount of $1.325 million. There are conflicting bona fide professional opinions about whether the sales documents obligated the Foundation to assume those deferred management fees and whether the Foundation actually did assume those liabilities.[179]

91. On January 6, 1999, Mr. Dougherty wrote a letter to Ms. Blaze, Mr. Jenson, and Dr. Zuckerman reminding them that he and his law firm were not representing the Foundation in matters relating to the purchase of the Odell Nursing

[174] Tr. 459-65, 714-16; Exh. 36.
[175] Tr. 459-61.
[176] Exh. 203, 579.
[177] *Id*.; Tr. 1117-22; 1127-30.
[178] Tr. 1115-16; Exh. 101.
[179] Tr. 154-60, 1123; Exh. 103, 111, 563.

Homes and urging them to engage independent counsel to advise them on matters relating to those acquisitions.[180]

92. The first face-to-face meeting of the Foundation Board occurred on February 4, 1999.[181] Mr. Odell was present at that meeting and at every subsequent face-to-face meeting of the Board up to and including the meeting that occurred on June 16, 1999, and while at Board meetings, Mr. Odell took an active part in Board discussions.[182]

93. After the Foundation purchased the three Odell Nursing Homes in January and February 1999, it took control of the local bank accounts of the Odell Corporations and used those accounts to fund its operations for some period of time.[183] From January to July 1999, Ms. Blaze, through her management company, Blaze & Phillips, controlled all of those accounts; she also possessed a signature stamp for Mr. Odell while she was actively managing the three homes for the Foundation.[184]

94. Between January 1 and June 16, 1999, the Foundation did not pay the Odell Corporations the full amounts due under the purchase money promissory notes that the Foundation had given to them when the sales of the three Odell Nursing Homes were closed. The Foundation was only paying the Odell Corporations enough to enable them to service the mortgage debt that they owed to Home Federal Savings.[185] During that period, Mr. Odell did not declare the Foundation to be in default, nor did he foreclose on the purchase money mortgages or take other steps to compel the Foundation to pay the full amounts due under those promissory notes.[186]

95. There was no written assurance that Mr. Odell would not foreclose until after the Foundation received a property rate increase from the Department.[187] However, Mr. Odell was willing to wait for the Foundation to begin making payments on its notes to the Odell Corporations so long as Ms. Blaze and her management company were managing the homes for the Foundation because Ms. Blaze was giving him money for his living expenses.[188] During the first five to six months of 1999, Ms. Blaze gave Robert Odell $1,000 per week for living expenses because Mr. Odell had no other sources of income at that time.[189]

96. Mr. Odell refinanced the mortgages held by Home Savings Bank and withdrew some of his existing equity in March 1999, after the closings on all three

[180] Exh. 515.
[181] Tr. 812. Ms. Blaze testified that before that, there had been some telephone conversations among individual directors.
[182] Exh. 202-1 at pp. 70-72, 77.
[183] Tr. 929-33, 1060.
[184] Tr. 1060.
[185] Tr. 730, 902.
[186] Exh. 200 at pp. 52-54.
[187] Tr. 219-20.
[188] Tr. 1059; Exh. 540.
[189] Tr. 857-58.

sales to the Foundation.[190] During his negotiations with Home Federal to refinance the underlying mortgages, Mr. Odell informed the bank that he was still active in the daily oversight of all the homes following the sales.[191]

97. On April 2, 1999, Mr. Dougherty sent a memorandum to Ms. Blaze, Mr. Jenson, Dr. Zuckerman, and Mr. Green outlining their legal rights as directors of nonprofit corporations and describing the duty of loyalty that they owed to their corporations.[192] Mr. Dougherty subsequently discussed the contents of his memorandum with the Board members at a Board meeting.[193]

98. Sometime in May 1999, Tom Dougherty received a call from Mr. Green complaining about Ms. Blaze and asking about the termination of her management contract. Mr. Dougherty considered these issues to create a conflict with Mr. Odell and his selling corporations and sent a letter terminating his limited representation of the Foundation.[194]

99. At a highly-contentious June 16, 1999 meeting of the Board of Directors, Mr. Jenson, Mr. Green and Mr. Borg elected Mr. Green as chairman over the votes of Ms. Blaze and Dr. Zuckerman. Based upon earlier discussions between those three Board members, attorney Doug Elsass with the law firm of Fruth and Anthony was present at the meeting and had been engaged by them to represent the Foundation.[195] Tom Hankes also attended the meeting and had brought with him the financial statements of the Foundation, but he left the meeting without presenting the financials.[196] At this same meeting, the Board also placed Blaze & Phillips on 30-day notice that its management contract would be terminated unless improvements were made within 30 days.[197] Curt Jenson was assigned to monitor and supervise the actions of the management company during this 30-day period. Robert Odell was also present at this meeting, and the newly configured Board informed him that the Foundation would not be paying him on his mortgages.[198]

100. On June 16, 1999, James Green, as the new Chair of the Foundation's Board, sent Blaze & Phillips a notice of the Foundation's intent to terminate its management agreement with Blaze & Phillips in 30 days.[199]

101. Two days later, on June 18, 1999, Robert Odell sent the three Odell Nursing Homes notices of default[200] because the Foundation had not been paying the full amounts owed on the purchase money promissory notes since January 1, 1999.[201]

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[190] Tr. 167; Exh. 580.
[191] Tr. 1054; Exh. 580 at 9.
[192] Exh. 34.
[193] Tr. 602.
[194] Tr. 177; Exh. 529.
[195] Tr. 737-39.
[196] Tr. 740.
[197] Exhs. 41, 531.
[198] Tr. 1078.
[199] Exh. 43.

102. In July 1999, the Foundation did terminate its management contract with Blaze & Phillips,[202] and Ms. Blaze and Dr. Zuckerman both resigned from the Board in July 1999. One month later, Ms. Blaze helped Mr. Odell prepare his foreclosure notice to the Foundation.[203] Mr. Odell also secured a temporary restraining order preventing the Foundation from re-directing property revenue to pay for other costs or services.[204]

Amendments to the Terms of the Sale

103. Prior to May 10, 1999, Ms. Blaze, representing the Foundation, and Mr. Odell, representing the Odell Corporations discussed the possibility of restructuring the terms of the sales to lower the purchase prices and raise the interest rates, as Mr. Betz had previously suggested. Ms. Blaze informed Mr. Odell that if he lowered the purchase price and increased the interest rate to 13%, the result would be a property rate that would be sufficient to service the debts that the Foundation owed to the Odell Corporations.[205] Ms. Blaze developed the 13% interest rate on her own, and Mr. Betz did not recommend that specific interest rate to her.[206]

104. On May 11, 1999, Ms. Blaze again met with Mr. Betz to discuss the property rate impact of the proposal she had outlined to Mr. Odell. Specifically, Ms. Blaze wanted assurance from the Department that a 13% interest rate would be allowable from a rate computation standpoint. Later that day, Mr. Betz responded to Ms. Blaze that a 13% interest rate would be allowable.[207] Thereafter, Ms. Blaze secured Mr. Odell's agreement to restructure the sales transactions to lower the aggregate sales price by about $2 million and to raise the interest rate to 13%.[208] By memorandum of the same date, Ms. Blaze informed the other Foundation Board members about the status of the discussions relating to amendment of the sales transactions.[209] None of them expressed objections or misgivings about restructuring the sales transactions in the way that Ms. Blaze proposed.[210] Ms. Blaze did not inform the other Foundation Board members that there would be prepayment penalty provisions in the amended sales transaction documents before she executed them on behalf of the Foundation.[211]

105. After Ms. Blaze and Mr. Odell reached agreement on amendments to the sale transactions, Mr. Odell instructed Mr. Dougherty to draft amended sales documents covering the sales of the three facilities from the Odell Corporations to the

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[200] Tr. 1086-88; Exh. 532.
[201] Tr. 730.
[202] Tr. 783.
[203] Exh. 47.
[204] Exhs. 44, 47, 61.
[205] Exh. 36.
[206] Tr. 462-63.
[207] The Rule 50 cap on interest rates is 16%. (Tr. 271-72).
[208] Tr. 719-20.
[209] Exh. 36.
[210] Tr. 724.
[211] Exh. 36.

Foundation.[212] The amended sales documents, which Mr. Dougherty prepared reduced the sales prices for the three facilities by about $2 million and increased the interest rates on the purchase money promissory notes from 10% to 13%, but prepayment penalties for the first five years of the agreements were also incorporated into the amended sales documents at Mr. Odell's request to ensure that he would receive the same amount of revenue that the original purchase agreements would have generated for him.[213]

106. On June 25, 1999, Ms. Blaze, acting under apparent authority of the Board's written actions of December 1, 1998, and February 1, 1999, executed the amended sales transactions on behalf of the Foundation and Mr. Odell on behalf of the Odell Corporations.[214] The amended sales documents specified an aggregate purchase price for the three facilities that was reduced from $8,420,000.00 to $6.4 million; the interest rate for all three transactions was increased from 10% to 13%, and prepayment penalty provisions that expired after five years were added to each of the transactions. The effective dates of the transactions, as they related to Crestview Manor and Pelican Lake Care Center, were back dated to January 1, 1999, and the effective dates of the transactions, as they related to MacIntosh Manor, were back dated to February 1, 1999.[215]

107. Also, on June 25, 1999, Ms. Blaze hand-delivered pertinent provisions of the amended sales documents to Mr. Betz and formally submitted them to the Department from the Foundation for the purpose of determining the post-sale property rates that would be payable to the Foundation.[216]

Establishment and Reversal of the Foundation's Property Rates

108. The Department did not process property rate adjustments reflecting the amended sales transactions immediately after Mr. Betz received the amended sales documents from Ms. Blaze. The Foundation did not begin receiving increased property rates for the three facilities until the fall of 1999. The reason for the delay was that the Foundation had not filed the necessary documents to obtain a new provider identification number from the Minnesota Department of Health.[217]

109. In early autumn 1999, after the Foundation had obtained a new provider number, the Department made upward adjustments of the property rates for the Foundation's Crestview, Pelican Lake, and McIntosh nursing homes to reflect the Department's recognition of the sales of those facilities on January 1 and February 1, 1999, as reflected in the amended Asset Purchase Agreements.[218] In addition to paying the higher property rates to the Foundation prospectively, the Department also made

[212] Exh. 36; Tr. 945.
[213] Tr. 173, 716-27, 945-46, 1045-46; *see* Exhs. 13 and 20, each at Tab 9; Exh. 14 at Tab 10.
[214] Tr. 722-23; Exhs. 13 and 20, each at Tab 9; Exh. 14 at Tab 10.
[215] Exhs. 13 and 20, each at Tab 9; Exh. 14 at Tab 10..
[216] Tr. 723-24.
[217] Tr. 727-29.
[218] *Id*.; Exh. 200 at pp. 106-07.

those rate adjustments retroactive to the actual dates of sale and began paying retroactive adjustments to the Foundation.[219]

110. The Department subsequently conducted a special field audit of the circumstances surrounding the sales of the three nursing homes from the Odell Corporations to the Foundation. On February 20, 2001, the field auditor issued a 23-page Special Field Audit Report containing numerous findings of fact relating to the circumstances surrounding those sales. Based on those findings, the field auditor concluded that those sales transactions constituted related party transactions within the meaning of applicable statutes and rules. The field auditor therefore recommended that the property rate increases that the Department had previously granted to the Foundation be disallowed and that the property rates for the three facilities "be rescinded to the rate in effect prior to the sale."[220]

111. The Department forwarded the field auditor's report to the Foundation and to the Odell Corporations on March 14, 2001. Based on the field auditor's report and recommendations, the Department disallowed both the retroactive and prospective property rate increases that the three nursing homes had been receiving since early autumn 1999 and readjusted their property rates back to what they had been prior to the sale.[221]

112. On May 10, 2001, the Foundation and the Odell Corporations jointly filed an administrative appeal of those March 14, 2001, disallowances and rate readjustments.[222]

113. By an Appeal Determination issued on April 12, 2002, the Department affirmed the field audit reversals to the property rates that the Department had made on March 14, 2001.[223]

114. On September 13, 2001, the Department issued Desk Audit Notices of Final Payment Rate Effective July 1, 2001, to each of the Foundation's three nursing homes. In effect, those desk audit notices established the property rates before the sales to the Foundation as the basis for the property rates for the three facilities for the rate year beginning on July 1, 2002, and all future years.[224]

115. On October 16, 2001, the Foundation filed an administrative appeal of those September 13, 2001, disallowances and rate readjustments.[225]

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[219] Tr. 728; 764-65.
[220] Exh. 4 at 21.
[221] Exhs. 568-570.
[222] Exh. 1. The Department also disallowed some other costs based on the results of the field audit, but only the disallowances relating to the sales of the facilities to the Foundation are at issue in this contested case proceeding.
[223] Exh. 3.
[224] Exh. 2.
[225] *Id*.

116. By an Appeal Determination issued on December 9, 2002, the Department determined that no change would be made to the property related payment rates for the three facilities effective July 1, 2001.[226]

117. The Foundation declined to accept the Department's Appeal Determinations of April 12 and December 9, 2002, and requested a hearing on the appealed items.[227]

Prior Proceedings

118. On February 12, 2003, the Department issued the Notice of and Order for Hearing and Prehearing Conference in this matter, and this contested case proceeding ensued.

119. On April 2, 2003, the Foundation filed a motion for summary disposition. On April 18, 2003, the Department filed a motion for partial summary disposition on a claim of estoppel raised by the Foundation. The Department's response and motion were also accompanied by numerous exhibits and other supporting documentation.

120. On September 23, 2003, the ALJ issued a report recommending that the Commissioner grant the Department's motion for partial summary disposition on the Foundation's estoppel claim. The Foundation's motion for summary disposition was based on its interpretation of the language of the related party rule (Minn. R. pt. 9549.0020, subp. 38). In his report, the ALJ recommended that the Commissioner reject the Foundation's interpretation and accept the Department's interpretation of that rule. However, since acceptance of the Department's interpretation required application of the rule to facts that appeared to be in dispute, the ALJ kept the Foundation's motion for summary disposition under advisement and directed the parties to proceed with discovery to determine what, if any, facts relating to application of the related party rule were in dispute.

121. The parties were unable to complete discovery relating to the Foundation's pending motion for summary disposition until late 2003. Thereafter, they submitted additional affidavits and authority, and the ALJ closed the record on that motion on January 14, 2004. Subsequently, on February 12, 2004, the ALJ issued a report recommending that the Commissioner deny the Foundation's motion for summary disposition.

122. Since the Administrative Law Judge's recommendations on the parties' motions for summary disposition did not involve a recommendation that the Commissioner make a final adjudication on the merits, the parties requested leave to continue with discovery relating to the issues that would be raised in the evidentiary hearing. The Administrative Law Judge established a discovery schedule and set this matter for an evidentiary hearing.

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[226] Exh. 3.
[227] Notice of and Order for Hearing and Prehearing Conference at 2.

123. After prehearing discovery was completed, the Foundation filed a second motion for summary disposition on July 14, 2005, contending that prehearing discovery established the absence of genuine issues of material fact and that the Foundation was therefore entitled to favorable adjudication on the merits as a matter of law. The ALJ took the Foundation's second motion for summary disposition under advisement pending completion of the evidentiary hearing.

124. The Administrative Law Judge conducted the hearing in this matter beginning on Monday, August 22, 2005, and continuing until Thursday, September 1, 2005. The OAH hearing record closed on November 21, 2005.

Other Findings

125. These Findings are based on all of the evidence in the record. Citations to portions of the record are not intended to be exclusive references.

126. The Memorandum that follows explains the reasons for these Findings of Fact, and to the extent that the Memorandum may contain additional findings of fact the Administrative Law Judge incorporates them into these Findings.

127. The Administrative Law Judge adopts as Findings any Conclusions that are more appropriately described as Findings.

CONCLUSIONS OF LAW

1. Minnesota law gives the Administrative Law Judge and the Commissioner authority to conduct this contested case proceeding and to make findings, conclusions, and recommendations or a final order, as the case may be.[228]

2. The Department gave proper and timely notice of the hearing, and they have also fulfilled all procedural requirements of law and rule so that this matter is properly before the Administrative Law Judge.

3. The Foundation's request for a contested case hearing on the appeal items addressed in the Department's appeal determinations of April 12 and December 9, 2002, nullifies those appeal determinations for the appeal items addressed therein. This contested case therefore involves *de novo* review of those appeal items.[229]

4. The Foundation must demonstrate by a preponderance of the evidence that the Department's determinations of the Foundation's payment rates in the appeal determinations of April 12 and December 9, 2002, were incorrect.[230]

[228] Minn. Stat. §§ 14.50, 14.57, 14.69, and 256B.50.
[229] Minn. Stat. § 256B.50, subd. 1c(c).
[230] Minn. Stat. § 256B.50, subd. 1c(d).

5. The Department is not estopped from disallowing increases for the property-related rates of the three Odell Nursing Homes resulting from the Foundation's purchase of those facilities from the Odell Corporations because of advice allegedly provided to the Foundation by a Department staff person concerning the sales.[231]

6. Minn. Stat. § 256B.431, subd. 14(a) and (d)(7) provide that a nursing home's property rate may be adjusted when it is sold unless the sale was between "related organizations."

7. Minn. R. pt. 9549.0020, subp. 38, provides in part that:

> "[r]elated organization" means a person that furnishes goods or services to a nursing facility and that is a close relative of a nursing facility, an affiliate of a nursing facility, a close relative of an affiliate of a nursing facility, or an affiliate of a close relative of an affiliate of a nursing facility. As used in this subpart:
>
> A. An "affiliate" is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with another person.

8. Minn. R. pt. 9549.0020, subp. 38D, provides:

> D. "Control" including the terms "controlling," "controlled by," and "under common control with" is the possession, direct or indirect, of the power to direct or cause the direction of the management, operations, or policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

9. For purposes of Minn. R. part 9549.0020, subp. 38D, the term "control" includes the power of one party to a nursing home sale to control the affairs of the other through indirect influence.[232]

10. On January 1 and February 1, 1999, Crestview Manor, Inc., Pelican Lake Health Care Center, Inc., and McIntosh Manor, Inc., of which Mr. Odell was the sole shareholder, sold the three nursing homes owned by those corporations to the Foundation.

11. A preponderance of the evidence established that before, during, and after the sale of the nursing homes described in Conclusion 10, Mr. Odell possessed the power to control the business affairs of the Foundation through his relationships and influence with Coral Blaze, Curtis Jenson, Thomas Dougherty, and Bruce Farrington.[233]

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[231] *See* Part I-C of the Memorandum that follows.
[232] *See* Part II of the Memorandum that follows.
[233] *See* Part III of the Memorandum that follows.

12. A preponderance of the evidence established that before, during, and after the sale of the nursing homes described in Conclusion 10, Mr. Odell exercised his power to control the business affairs of the Foundation through his relationships and influence with Coral Blaze, Curtis Jenson, Thomas Dougherty, and Bruce Farrington.[234]

13. A preponderance of the evidence established that before, during, and after the sale of the nursing homes described in Conclusion 10, Mr. Odell was an affiliate of the Foundation within the meaning of Minn. R. pt. 9549.0020, subp. 38A.

14. The sales of the nursing homes described in Conclusion 10 were therefore sales between related organizations within the meaning of Minn. Stat. § 256B.431, subd. 14(a) and (d)(7).

15. The Foundation therefore failed to demonstrate by a preponderance of the evidence that the Department's determinations of the Foundation's payment rates in the appeal determinations of April 12 and December 9, 2002, were incorrect.

16. The Administrative Law Judge adopts as Conclusions any Findings that are more appropriately described as Conclusions.

17. The Memorandum that follows explains the reasons for these Conclusions, and the Administrative Law Judge therefore incorporates that Memorandum into these Conclusions.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATIONS

The Administrative Law Judge therefore RESPECTFULLY RECOMMENDS:

1. That the Commissioner AFFIRM the Administrative Law Judge's recommendation of September 22, 2003, that the Department's motion for partial summary disposition of April 18, 2003, be GRANTED;

2. That the Commissioner AFFIRM the Administrative Law Judge's recommendation of February 12, 2004, that the Foundation's motion for summary disposition of April 2, 2003, be DENIED;

3. That the Commissioner DENY the Foundation's motion for summary disposition of July 14, 2005, that was taken under advisement by the Administrative Law Judge pending completion of the hearing in this contested case proceeding; and

[234] *See* Part IV of the Memorandum that follows.

4. That the Commissioner AFFIRM the Desk Audit Notices of Final Payment Rate Effective July 1, 2001, that the Department issued to the Foundation on September 13, 2001.

This 20th day of December, 2005.

_/s/ Bruce H. Johnson_____
BRUCE H. JOHNSON
Administrative Law Judge

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MEMORANDUM

I.
Matters at Issue; Burdens of Proof

A. Contested Issues of Fact

On February 20, 2001, the Department issued a Special Field Audit Report that recommended disallowance of increases that the Department had previously allowed for the property-related rates of the three Odell Nursing Homes resulting from the Foundation's purchase of those facilities from the Odell Corporations. The field auditor's recommendation was based on his conclusion that those sales constituted related organization transactions that were not eligible for stepped up property rates under the applicable statute and rules. That conclusion, in turn, was based on some twenty pages of findings of fact that the field auditor included in his report.[235] The Department subsequently issued formal written disallowances of those stepped-up property rates on March 14, 2001.[236] Those disallowances were based on the conclusion that the sales were "related party transaction[s], because of Mr. Odell's substantial control of these facilities," and letters of disallowance indicated that that conclusion was based on the field auditor's findings of fact.[237] The Foundation appealed those disallowances, and the Department rejected those appeals in two Appeal Determinations dated April 12 and December 9, 2002—the former dealing retroactively with property rates in effect from the dates of the sales through June 30, 2001, and the latter dealing prospectively with property rates in effect after July 1, 2001.[238] The Department's two Appeal Determinations were primarily conclusory in nature but did summarize some of the field auditor's findings of fact. The Foundation subsequently rejected both Appeal Determinations, requested a hearing, and this contested case proceeding ensued.

In a contested case proceeding to appeal a nursing home rate appeal determination, "the appealing party must demonstrate by a preponderance of the evidence that the determination of a payment rate is incorrect."[239] Additionally, it is prevailing law that "[a] contested case demand for an appeal item nullifies the written appeal determination issued by the commissioner for that appeal item," and, therefore, the contested case is a *de novo* review by the presiding ALJ, who may base his or her findings of fact on any evidence presented at the hearing.[240] Attempting to determine how those two legal principles interact complicated both the conduct of the hearing, and the ALJ's assessment of the parties post-hearing arguments.[241] At the hearing, the ALJ

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[235] Exh. 4.
[236] Finding 111.
[237] Exh. 568-570.
[238] Exh. 3.
[239] Minn. Stat. § 256B.50, subd. 1c(d)
[240] Minn. Stat. § 256B.50, subd. 1c(c); *see also Sleepy Eye Care Center v. Comm'r of Human Services*, 572 N.W.2d 766, 771 (Minn. Ct. App. 1998).
[241] Minn. Stat. § 256B.50, subd. 1c, appears to create a contradiction. Subdivision 1c(c) states that "a contested case demand for an appeal item nullifies the written appeal determination issued by the commissioner." Subdivision 1c(d) states that "the appealing party must demonstrate by a preponderance

received the field auditor's report as evidence for the limited purpose of establishing what notice the Foundation received concerning the subsequent field audit disallowances; it was not received as evidence of the truth of any matter asserted in that report.[242] The Department clearly stated that it would rely on facts established during the hearing to establish the existence of related organization transactions and not solely on the findings of facts that were made in the Special Field Audit Report. It was the Foundation's burden to present evidence that Mr. Odell and his selling corporations, on the one hand, and the Foundation, on the other, were not "related organizations." As bearer of the burden the Foundation chose to present its evidence first, and it chose to present evidence that contradicted all of the findings in the field auditor's report. However, the Department, both in cross-examination of the Foundation's witnesses and in its own case in chief, did not present evidence to support all of the findings in the field auditor's report. Accordingly, the ALJ has addressed only the issues of fact that the Department raised at the hearing. Accordingly, the Foundation must establish by a preponderance of evidence that the facts that the Department relied on to establish a related organization transaction were incorrect.

B. Claims of Arbitrary and Capricious Conduct by the Department

On August 8, 2005, the Department filed a motion in limine to exclude certain evidence from the hearing as irrelevant, immaterial, or repetitious. Some of the evidence that the Department sought to exclude related to whether the Appeal Determinations at issue here were "arbitrary and capricious" because they were infected by bias, ill will, and misconduct on the part of Department staff. The Foundation further argued that the ALJ had jurisdiction to consider those claims. In an Order on the motion in limine entered on August 17, 2005, the ALJ granted that part of the Department's motion after concluding that Minn. Stat. § 256B.50 limited his jurisdiction "to determin[ing] the proper resolution of specified appeal items,"[243] and that claims that the rate setting process was more generally arbitrary and capricious in the ways being alleged were claims that were outside the ALJ's jurisdiction. Nevertheless, the Foundation requested leave to present evidence relating to those issues as an offer of proof. Thereafter, the ALJ granted the Foundation leave to make that offer of proof during the hearing, but the ALJ necessarily has neither made findings of fact nor drawn any conclusions relating to those issues.

C. The Foundation's Claims of Estoppel

On April 2, 2003, the Foundation filed a motion for summary disposition based in part on a claim that the Department should be estopped from making the field audit reversals to the Foundation's property rates primarily because the Foundation relied on advice it had received from a Department staff person concerning the sale. The

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of the evidence that the determination of a payment rate is incorrect." This seems to place the appealing party in the position of demonstrating by a preponderance of the evidence that a *nullified* determination of a payment rate is incorrect.

[242] Tr. 11.

[243] Minn. Stat. § 256B.50, subd. 1c(c).

Department responded to that part of that motion for summary disposition[244] by bringing a Motion for Partial Summary Disposition on the issue of estoppel, stating that the Foundation had failed to allege facts sufficient to establish the elements of estoppel. By report dated September 23, 2003, the ALJ recommended that the Commissioner grant the Department's motion for partial summary disposition of the estoppel issue. Neither of the parties sought an interlocutory order from the Commissioner on that motion; therefore, that issue has not yet been finally adjudicated. In this report, the ALJ repeats his recommendation of September 23, 2003, on that issue for the reasons set forth in the Memorandum that accompanied that earlier report.

II.
Interpretation of the "Related Organization" Rule.

The Foundation's motion for summary disposition of April 2, 2003, was also based on another question of law—namely, interpretation of the meaning of the term "related organization" in Minn. R. pt. 9549.0020, subp. 38D. The Foundation maintained that the type of control to which the rule refers is that which is direct and tangibly evidenced or acknowledged in some way, *e.g.*, as the power to control arising out of legal status, such as ownership of shares, or at least an express agreement to exert influence that could be established by one of the parties to the sale. On the other hand, the Department contended that the rule embraces a broader sense of the word "control" that extends beyond the Foundation's interpretation to less direct and obvious methods of influencing the management, operations, and policies of the buyer. In a report issued on February 12, 2004, the ALJ recommended that the Commissioner deny the Foundation's motion for summary disposition as it related to that claim. Again, neither of the parties sought an interlocutory order from the Commissioner on the ALJ's recommendation on that motion; therefore, there has been no final adjudication on that issue of law. Determination of the issues of fact raised in the hearing necessarily begin with how the term "control" should be interpreted.

Minn. Stat. § 256B.431, subd. 14(a) and (d)(7) provide that a nursing home's property rate may be adjusted when it is sold unless the sale was between "related organizations." The sole issue in this case is whether the sales from the Odell Corporations to the Foundation were between "related organizations": within the meaning of the applicable statute. The Legislature did not define the term "related organization" by statute in Chapter 256B. Rather, the Department defines the term in Minn. R. pt. 9549.0020, subp. 38 (sometimes hereafter the "Related Organization Rule"). Accordingly, the issue in this proceeding more precisely is whether the sales in question were between "related organizations" within the meaning of the applicable rule.

[244] Prior to the hearing, the Foundation filed two motions for summary disposition, and the Department filed one motion for partial summary disposition. The Foundation's most recent motion for summary disposition was filed on July 14, 2005, five weeks before the hearing. The ALJ took that motion under advisement pending the outcome of the hearing and in this report has recommended that the Commissioner deny that motion.

The Department's definition of related organization in Minn. R. pt. 9549.0020, subp. 38, and of a provision disallowing "debt incurred as a result of loans between related organizations"[245] were actually adopted as rules before the Legislature enacted the statutory provision disallowing adjustment of property rates in sales between related organizations.[246] However, when the Legislature enacted the 1992 amendments to Chapter 256B that added Minn. Stat. § 256B.431, subd. 14(a) and (d)(7), it also specifically provided that "[t]erms used in subdivisions 13 to 21 shall be as defined in Minnesota Rules, parts 9549.0010 to 9549.0080, and this section."[247] In other words, the Legislature specifically incorporated the Department's earlier rule defining "related organization" and other substantive provisions of Minn. R. Chapter 9549 into the new statutory provision that disallowed adjustment of property rates in sales between related organizations. Put another way, the Legislature intended the Department's rule defining related organizations to have statutory status.

The term "related organization" is defined as follows:

> Subp. 38. **Related organization.** "Related organization" means a person that furnishes goods or services to a nursing facility and that is a close relative of a nursing facility, an affiliate of a nursing facility, a close relative of an affiliate of a nursing facility, or an affiliate of a close relative of an affiliate of a nursing facility. As used in this subpart:
>
> A. An "affiliate" is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with another person.
>
> B. A "person" is an individual, a corporation, a partnership, an association, a trust, an unincorporated organization, or a government or political subdivision.
>
> C. A "close relative of an affiliate of a nursing facility" is an individual whose relationship by blood, marriage, or adoption to an individual who is an affiliate of a nursing facility is no more remote than first cousin.

[245] Minn. R. pt. 9549.0060, subp. 5E.

[246] The Department adopted the rule on June 10, 1985 (9 S.R. 2659). The Legislature did not enact Minn. Stat. § 256B.431, subd. 14(a) and (d)(7) until April 29, 1992. (Minn. Laws 1992, ch. 513, art. 7, § 96, *codified as* Minn. Stat. § 256B.431, subd. 14). Prior to that, there was no statutory provision disallowing adjustment of property rates in sales between related organizations. (*See* Minn. Stat. § 256B.431 (1984).) That is not an anomaly. At the time the rule was adopted, there were reimbursement limitations in rule on various kinds of transactions between related organizations, (*See*, *e.g.*, Minn. R. pt. 9549.0035, subp. 7 (1985)), including disallowance of debt incurred as a result of loans between related organizations. (*See* Minn. R. pt. 9549.0060, subp. 5E (1985).)

[247] *See* Minn. Stat. § 256B.431, subd. 13(a).

> D. "Control" including the terms "controlling," "controlled by," and "under common control with" is the possession, direct or indirect, of the power to direct or cause the direction of the management, operations, or policies of a person, whether through the ownership of voting securities, by contract, or otherwise.[248]

The Foundation's and Department's differing interpretations of the rule focused on the *source* from which a party to a sale acquires the power to direct the affairs of the other party. The Foundation interprets the rule narrowly. It contends that the rule creates a related organization situation only when the source of one party's power to direct the affairs of the other arises from a formal legal relationship or from an express agreement or understanding between both parties to the sale. On the other hand, the Department interprets the rule more broadly. It contends that the rule creates a related organization situation whenever one party has effective power of some kind to direct the affairs of the other—that is, the power to control through indirect influence—regardless of the source of that power and influence.

A. The plain language of the Related Organization Rule supports a broad interpretation.

When resolving differing interpretations of a rule, one should first look at the plain meaning of the language.[249] The statute or Related Organization Rule itself defines the term "control." That definition, in turn, centers on the term "power," which is not defined. A term that is not defined in the rules is "construed according to rules of grammar and according to [its] common and approved usage."[250] *The American Heritage College Dictionary* defines "power," in relevant part, as "1. the ability or capacity to perform or act effectively. . . . 4. The ability or official capacity to exercise control; authority. 5. A person . . . having great influence or control over others."[251] In other words, the term "power," as used in the rule, has more than one plain meaning, or sense. So, there are common and ordinary senses of the terms "power" and "control" that support both parties' interpretations of the rule, with the Foundation arguing for a narrow interpretation based on one or just a few common senses of those terms and with the Department arguing for a broader interpretation that embraces all of the common and ordinary senses of those words. So the inquiry necessarily turns to whether the plain meaning of the rule's language supports either interpretation and to whether or not there is other language in the rule that may aid in determining whether the drafter intended a narrow or a broad interpretation of the term "possession of the power to direct." Both parties argued that there is other language that supports their respective interpretations.

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[248] Hereafter, Minn. R. pt. 9549.0020, subp. 38, is frequently referred to as the "Related Organization Rule."
[249] Minn. Stat. § 645.08(1).
[250] *Id*.
[251] The American Heritage College Dictionary (4th ed.), p. 1092.

In defining "possession of the power to direct," the rule describes potential sources of that power as arising "through the ownership of voting securities, by contract, or otherwise." The Foundation argues that the two sources of the power to direct, which the rule explicitly describes, both relate to power acquired by legal status. And in essence, the Foundation goes on to interpret the phrase "or otherwise" as meaning "or other sources of power that are similar in origin to the two that have been explicitly described." The Department, on the other hand, interprets the phrase "or otherwise" as referring to the many ways, other than having legal status, that a person could acquire the "power to direct or cause the direction of" the business affairs of the other party to a sale. Although it might be possible to interpret the term "or otherwise" either way, the Minnesota Supreme Court actually encountered and construed that term in another context in *Clinton Co-op Farmers Elevator Association v. Farmers Union Grain Terminal Association*.[252] What was at issue there was interpretation of the phrase "either as agent or otherwise." In resolving that issue, the Court concluded that the plain and usual meaning of the phrase "or otherwise" was "all-inclusive and cover[ed] the capacity of defendant to buy in any manner it sees fit."[253] So the case law weighs against the Foundation's narrow interpretation of the phrase "or otherwise" in this rule.

There is also other language in the rule that supports the Department's interpretation. The rule speaks in terms of "the possession, *direct or indirect*, of the power to direct . . ." The two methods of acquiring control that the rule explicitly describes—namely, "through the ownership of voting securities [and] by contract"—are clearly both methods of direct control. And the substance of the Foundation's argument is that a related organization situation only occurs when the power to control is acquired by direct means.[254] But insertion of the phrase "direct or indirect" into the rule is evidence of a contrary intent—that is, an intent to broaden application of the rule to extend to situations where a party has acquired the "power to direct" by indirect means. A fundamental rule of construction is:

> … [A] statute is to be read and construed as a whole so as to harmonize and give effect to all of its parts. Moreover, provisions of the same statute must be interpreted in light of each other, and the legislature must be presumed to have understood the effect of words and intended the entire statute to be effective and certain.[255]

The phrase "direct or indirect" only has meaning under the Department's interpretation of the rule. On the other hand, under the Foundation's interpretation, that phrase would create confusion and an apparent internal contradiction.

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[252] 26 N.W.2d 117 (Minn. 1947).
[253] *Id*. at 120.
[254] The Foundation indicated that where buyers "had pledged to be mere straw men and had agreed to follow the seller's orders" would also trigger application of the rule. *See* n. 6, *supra*. But there is nothing indirect about that method of acquiring control. It would still be predicated on an express agreement among parties to a sale.
[255] *Van Asperen v. Darling Olds, Inc.*, 93 N.W.2d 690, 698 (Minn. 1958).

B. The underlying purposes and intent of the Related Organization Rule support a broad interpretation of the Rule.

Rulemaking is lawmaking, a legislative activity. So the object of interpreting and construing a rule is to ascertain the intent of the drafter.[256] When the words of the rule do not appear to be explicit, the intent of the drafter may be ascertained, among other ways, by considering '[t]he occasion and necessity for the law," "[t]he mischief to be remedied," and "[t]he object to be attained."[257] Minn. Stat. § 256B.431, subd. 14(d), which Minn. R. pt. 9549.0020, subp. 38 interprets, provides that the Department must not increase the property rates following sale and purchase of a nursing facility's capital assets in the following situations:

> (1) a sale and leaseback to the same licensee that does not constitute a change in facility license;
>
> (2) a transfer of an interest to a trust;
>
> (3) gifts or other transfers for no consideration;
>
> (4) a merger of two or more related organizations;
>
> (5) a change in the legal form of doing business, other than a publicly held organization that becomes privately held or vice versa;
>
> (6) the addition of a new partner, owner, or shareholder who owns less than 20 percent of the nursing facility or the issuance of stock; and
>
> (7) a sale, merger, reorganization, or any other transfer of interest between related organizations other than those permitted in this section.

The clear intent of the legislature and of the Department's interpretive rule is to prevent providers from obtaining a financial benefit from sales transactions that are a sham or for some reason are not considered to be at arm's length. Sales transactions that are something less than arm's length transactions might result from one party's direct control over the business of the other, but it is equally possible for such transaction to result from a party's indirect control or influence over the other. Moreover, the Statement of Need and Reasonableness that the Department published in connection with the adoption of the rule clearly supports a conclusion that those were the Related Organization Rule's purposes:

> The Department seeks to insure that it is paying for the costs of goods and services which are obtained at competitive prices. It is reasonable to obtain goods and services from unrelated organizations because it may be assumed that such goods and services are acquired in a marketplace of arm's length transactions.[258]

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[256] Minn. Stat. § 645.16.
[257] *Id*.
[258] Exh. 300 at pp. 22-23. At the close of the hearing, the ALJ requested the Department to submit as an additional exhibit the Statement of Need and Reasonableness (SONAR) that the Department issued when it adopted the Related Organization Rule in 1985, with copy to opposing counsel. The Department

In summary, the ALJ concludes that the purposes and history of the rule support the interpretation that a related organization can be established when one party to the sale of a nursing home has the power to control the affairs of the other through indirect influence.[259]

C. No longstanding interpretations of the Related Organization Rule exist that conflict with the Department's interpretation in this proceeding.

An agency's interpretation of its own rule must be accorded deference "when language subject to construction is so technical in nature that only a specialized agency has the expertise needed to understand it, * * * when the language is ambiguous *or* when the agency interpretation is one of long standing."[260] There are situations where courts have found an agency interpretation of an interpretive rule amounts to a new rule that has never been properly adopted. That is what the Foundation previously argued in its first motion for summary disposition. When that issue is raised, the agency's interpretation must be analyzed to determine whether it is "a permissible interpretation of the current rule or an improper promulgation of a new rule."[261] The Minnesota Supreme Court has held that "if the agency's interpretation of a rule corresponds with its plain meaning, or if the rule is ambiguous and the agency interpretation is a longstanding one, the agency is not deemed to have promulgated a new rule."[262]

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submitted that SONAR for inclusion in the hearing record by letter dated September 7, 2005. The ALJ has included that SONAR in the hearing record as Exhibit 300.

[259] To some extent, both parties, particularly the Department, referred to a somewhat similar federal related organization regulation that applies to providers of nursing home services in the federal Medicare program. The Department also referred to federal cases interpreting and applying that regulation. (Department's Post-Hearing Memorandum at pp. 3-8) The Foundation argues that accepting the federal regulation's definition of related organization would amount to rulemaking that is not in conformity with the provisions Minn. Stat. Ch. 14. (Foundation's Response Memorandum at pp. 12-17) While the ALJ is not prepared to conclude that relying on all or part of the federal regulation would amount to applying an unadopted rule, the ALJ recommends that Commissioner not rely on federal authority in interpreting Minnesota's Related Organization Rule. First, there are some potentially significant differences in language between federal regulation and the Minnesota rule. Second, the rulemaking history of Minn. R. pt. 9549.0020, subp. 38, does not unequivocally establish an intent that the rule and the federal regulation have identical interpretations. Third, the federal case law is not authoritative of the interpretation of a Minnesota Rule. However, the ALJ believes that the federal case law is useful in a limited way. First, it confirms what the ALJ previously concluded—that is, that determinations of the power to control and whether that power has been exercised in a particular case are essentially fact-based inquiries. Second, what the federal cases also indicate is that the potential for or exercise of "control" can be established by reasonable inferences drawn from the evidence.

[260] In *the Matter of the Contested Case of Ebenezer Society v. Minnesota Department of Human Services*, 433 N.W.2d 436, 439 (Minn.Ct.App. 1988), *quoting* Resident v. Noot, 305 N.W.2d 311, 312 (Minn. 1981). [Emphasis supplied.]

[261] Cable *Communications Board v. Nor-West Cable Communications Partnership*, 356 N.W.2d 658 (Minn. 1984).

[262] *Id.* at 667 (*citing White Bear Lake Care Center, Inc. v. Minn. Dep't of Public Welfare*, 319 N.W.2d 7, 8 (Minn. 1982)).

Further, "[i]f an agency interpretation [of a rule] merely restates existing policy, or is consistent with the regulation it implements, the court has upheld the agency action."[263]

In connection with its earlier motion for summary disposition, the Foundation contended that the Department had a longstanding interpretation of its Related Organization Rule that was different from the interpretation of the rule it was advancing in this proceeding. Whether an agency has a longstanding interpretation of a rule and what that interpretation might be are questions of fact that must be established by a preponderance of the evidence.[264] Therefore, on September 23, 2003, the ALJ initially took the Foundation's motion under advisement and allowed the Foundation to conduct discovery regarding any conflicting longstanding interpretation by the Department of the rule. After that discovery was completed, the ALJ later denied the Foundation's motion in the report dated February 12, 2004. There, the ALJ concluded that there was no longstanding interpretation of the Related Organization Rule by the Department that conflicted with the interpretation it was relying on in this proceeding.

D. Interpretation of the Related Organization Rule as it applies in this proceeding.

In summary, the ALJ concludes that an interpretation of the Related Organization Rule that allows establishment of a related organization relationship based on the power to control through indirect influence is consistent with plain meaning of the language of the Rule, as well as the Rule's underlying purposes and history. Additionally, the evidence that the Foundation produced earlier failed to establish a conflicting and longstanding agency interpretation by a preponderance of the evidence. The ALJ therefore recommends that the Commissioner affirm the ALJ's previous recommendation on the Foundation's first motion for summary disposition.

Whether a related organization relationship exists under the interpretation of the rule that the ALJ has adopted therefore involves questions of fact, and the purpose of the evidentiary hearing in this matter was to resolve those questions of fact. Although there are some significant exceptions, the parties do not disagree about most of the underlying facts. But the parties do have two very different views of what can be inferred from the facts and of what conclusions can be reasonably drawn from facts and inferences. In essence, it is the Department's view that one must take a holistic view of the entire factual environment surrounding the sales transactions in question, and that when one does that, the factual environment as a whole compels the conclusion that Mr. Odell exercised control over the Foundation by indirectly influencing the persons involved with its formation and initial operations. The Foundation, on the other hand, takes the view that there is no direct evidence of any single act on Mr. Odell's part that unequivocally establishes an effort by him to control the affairs of the Foundation, and that a preponderance of the evidence therefore establishes that he did not exercise

[263] *Id.* (*citing Wacha v. Kandiyohi County Welfare Board*, 242 N.W.2d 837, 839 (Minn. 1976); *Jones v. Minnesota State Board of Health*, 221 N.W.2d 132 (Minn. 1974)).
[264] *See Petition of Fritz Trucking, Inc.*, 407 N.W.2d 447, 450 (Minn.App. 1987); Minn. R. pt. 1400.7300, subp. 5.

control over the Foundation. In effect, the Department argues that control by Mr. Odell can be generally inferred from the *res gestae*, while the Foundation argues that existence of such control cannot be established by inference alone. In the final analysis, the ALJ concludes that neither view is entirely correct. To establish the existence of control, there must be something stronger than a general inference based loosely on the surrounding fact pattern. On the other hand, the existence of control can be based on inferences, if the inferences are logical, reasonable, and sufficiently strong.

III.
Mr. Odell Possessed Power to Control the Foundation's Affairs Through His Relationships and Influence with Directors and Consultants

In its Post-Hearing Memorandum, the Department contends that the phrase "possession … of the power to direct," suggests that the possessor of the power need not actually exercise that power in order for there to be a related organization sale transaction. In other words, the Department argues that the mere capacity to control, without exercising that power, is sufficient to trigger Rule 50's prohibitions.[265] In support of that argument, the Department points to Minn. R. pt. 9549.0020, subp.38D, which provides that "the possession, direct or indirect, of the power to direct or cause the direction of the management, operations, or policies of a person, whether through the ownership of voting securities, by contract, or otherwise." The rule's plain language, the Department contends, does not require that a party to a nursing home sale actually exercise a demonstrated potential to control the other party to the sale in order for the transaction to be considered a related organization sale. Put another way, the Department's position appears to be that if a person's "power to direct" is established, it is conclusively presumed, as a matter of law, that that power has been exercised notwithstanding the absence of any evidence that it has been exercised. The Foundation did not directly address that contention, but rather asserted that the Department had failed to establish that Mr. Odell possessed the power to control.[266] However, the ALJ has concluded otherwise—that is, that a preponderance of the evidence established that Mr. Odell did possess the power, or potential, to control the affairs of the Foundation through indirect influence.

A. Mr. Odell possessed the power to control the Foundation's affairs through his relationships and influence with Ms. Blaze, Mr. Jenson, Mr. Dougherty, and Mr. Farrington.

The fact that Ms. Blaze was Mr. Odell's domestic partner, taken alone, does not make the transactions related organization transactions. However, when viewed together with other relevant facts, that relationship created a potential for him to control the affairs of the Foundation through his influence with her. In addition to that relationship, the evidence established that it was Mr. Odell who arranged for Ms. Blaze to be a member of the Foundation's Board of Directors and, more likely than not,

[265] Department of Human Services' Post-Hearing Memorandum, n. at p. 3.
[266] Foundation for Rural Health Care's Written Argument, n. 30 at p. 31.

President of the Foundation.[267] Before the Foundation was formed, Ms. Blaze had also been employed by Mr. Odell's management company to manage all three Odell Nursing Homes, effectively serving as chief operating officer for each of the Odell Corporations.[268] Mr. Odell had indicated to Mr. Farrington as early as April 1997 that one of his objectives in any sale of the nursing homes was securing Ms. Blaze's future employment.[269] Ms. Blaze was also directly involved with Mr. Hankes in creating the property rate estimates that Mr. Odell would later rely on in establishing the prices he would charge for the three homes.[270] Additionally, the evidence established that Mr. Odell was both directly and indirectly involved in the Foundation's decision to enter into a management agreement with Blaze & Phillips, an agreement that would result in continued employment for Ms. Blaze in essentially the same capacity as her previous employment with Mr. Odell.[271] In short, Mr. Odell's personal interests were aligned with those of Ms. Blaze, and he exercised his influence to place her in a position where she could protect his business interests. He therefore possessed the power to exercise control over the Foundation's affairs though his relationship and influence with her.

Before the Foundation was formed, Mr. Jenson was also an employee of Mr. Odell's, serving as the administrator of McIntosh Manor for most of the ten years before that nursing home was sold to the Foundation.[272] About a year before that sale, Mr. Jenson had learned that Mr. Odell was considering retirement from the nursing home business and selling all of the facilities he owned, including McIntosh Manor. At that time, Mr. Odell renegotiated his corporation's contract with Mr. Jenson and included a provision to pay Mr. Jenson $30,000 if Mr. Odell ever sold McIntosh Manor to someone else.[273] Thereafter, Mr. Odell recruited Mr. Jenson to be a member of the Foundation's Board of Directors[274] and arranged for him to be Vice President of the Foundation.[275] As a result of Mr. Odell's efforts, Mr. Jenson became a Foundation Board member who had a financial incentive to approve the sale of the Odell Nursing Homes to the Foundation on terms that were favorable to Mr. Odell. Mr. Jenson became a director of the Foundation on December 1, 1998.[276] However, he remained in Mr. Odell's employ as administrator of McIntosh Manor until the Foundation acquired that nursing home on February 1, 1999.[277] As a result, when Mr. Jenson approved the purchases of all three Odell Nursing Homes as a member of the Foundation's Board, he was contemporaneously a paid employee of Mr. Odell.

Although the ALJ has concluded below that Mr. Odell lacked the power to control the Foundation's affairs through his relationship with Dr. Zuckerman, neither Ms. Blaze nor Mr. Jenson can reasonably be considered to have been independent initial

[267] Findings 21 and 46.
[268] Finding 5.
[269] Finding 11.
[270] Finding 32.
[271] Findings 70 and 73.
[272] Finding 22.
[273] Finding 14.
[274] Finding 22.
[275] Finding 46.
[276] Finding 46.
[277] Exh. 201 at p. 170.

directors. Both had potentially conflicting interests, and Mr. Odell possessed the power to control the Foundation's affairs through them, as a majority of initial Board of Directors members.

Mr. Odell also possessed the potential to control the Foundation's affairs through his relationship and influence with Mr. Farrington. Mr. Farrington testified that he had ended his business association with Central Health Care Management and, at least by implication, with Mr. Odell in May 1998.[278] But the evidence established that he was contemporaneously providing consulting services to Mr. Odell, Ms. Blaze and Blaze & Phillips, and the Foundation from at least August 1998 through February 23, 1999.[279] Mr. Farrington helped Mr. Odell work out the details of establishing the Foundation.[280] He also helped Ms. Blaze craft the management contract between the Foundation and Blaze & Phillips and helped her determine the management fee that she would charge the Foundation.[281] Mr. Dougherty subsequently concluded that the fee charged in the Blaze & Phillips management contract might present a barrier to the Foundation obtaining 501(c)(3) from the IRS, and suggested lower fee provisions.[282] Then, without advising Mr. Dougherty that he had helped Ms. Blaze set the original fee, Mr. Farrington wrote a "reasonableness letter" for the IRS indicating the altered fee structure was fair and reasonable and supported that opinion with the same data he had provided to Ms. Blaze to establish the original higher fee.[283] While Mr. Farrington was performing these services for all three entities, he was being paid by Mr. Odell for all of those services.[284] Most notably, however, Mr. Farrington's January 16, 1998, consulting agreement with Mr. Odell provided that Mr. Farrington would be paid 1% of the purchase prices for the Odell Nursing Homes if they were ever sold.[285] In other words, the higher the purchase prices were, the higher Mr. Farrington's fee would be. This created a very strong potential for Mr. Odell to influence the business affairs of the Foundation through his relationship and influence with Mr. Farrington.

Mr. Dougherty had been providing legal services to Mr. Odell and his businesses since the mid-1990s.[286] Between August and December 1998, he provided legal assistance to Mr. Odell in forming and organizing the Foundation.[287] He later assisted the Foundation in obtaining § 501(c)(3) status from the IRS.[288] In December 1998, while Mr. Dougherty was representing Mr. Odell and the Odell Corporations in connection with their sales of the three nursing homes to the Foundation, he was also serving as corporate counsel for the Foundation.[289] During the same period, Mr. Dougherty represented Ms. Blaze's management corporation, Blaze and Phillips, by

[278] Finding 15.
[279] Findings 19, 21, 62, 64, 68, and 70.
[280] Finding 19.
[281] Finding 68.
[282] Finding 64.
[283] Finding 64.
[284] Findings 48 and 64.
[285] Finding 13.
[286] Finding 16.
[287] Findings 20 and 42-45.
[288] Findings 51, 52, and 61-65.
[289] Finding 44.

drafting the management agreement she submitted to the Foundation's Board.[290] Also, from August 1998 until June 1999, Mr. Dougherty was representing Mr. Odell and the Odell Corporations in connection with the sales of the Odell Nursing Homes to the Foundation.[291] Central Health Care Management, Mr. Odell's management corporation, paid Mr. Dougherty's fees and expenses for his representation of all three entities, and Mr. Dougherty sent Mr. Odell copies of the documents he prepared for all three entities.[292] Mr. Dougherty was clearly uncomfortable about the potential for conflicts that arose from his multiple representation. He disclosed it, and the parties agreed to it.[293] He repeatedly urged the Foundation to obtain other legal representation for matters relating to the sale of the nursing homes;[294] he personally advised the Foundation's Board members about their duty of loyalty to that corporation,[295] and when a clear conflict arose between Mr. Odell's interests and the Foundation's, he ended his representation of the Foundation.[296] Throughout all of this, it was clear that Mr. Odell was his primary client, and that his representation of Mr. Odell and his interests were paramount. An inference that can reasonably be drawn from these facts is that Mr. Odell had the potential to control the affairs of the Foundation through his influence with Mr. Dougherty. However, whether Mr. Odell actually exercised that potential is a separate question that is addressed below.

B. Mr. Odell did not possess the power to control the Foundation's affairs through his relationships and influence with Dr. Zuckerman, Mr. Hankes, Mr. Green, and Mr. Borg.

Dr. Zuckerman had been a long-time acquaintance of Mr. Odell before being recruited by Mr. Odell to be an initial member of the Foundation's Board.[297] He considered his role on the Board to be limited to general oversight and planning, and he did not actively involve himself with the Foundation's day-to-day operations or specific business transactions. [298] More to the point, he simply trusted Ms. Blaze and Mr. Jenson to look after the Foundation's interests in connection with the Foundation's purchase of the three Odell Nursing Homes.[299] Dr. Zuckerman believed that Ms. Blaze and Mr. Odell were taking care of all the necessary work to form the Foundation properly.[300] His disengagement from the details of the sales was such that he believed that an independent consultant had provided the Foundation with an opinion about the sales price.[301] What can reasonably be inferred from these facts is that Dr. Zuckerman

[290] Finding 70.
[291] Findings 42, 52, 55, 57, and 105.
[292] Findings 48 and 49.
[293] Finding 44.
[294] Finding 91.
[295] Finding 97.
[296] Finding 98.
[297] Tr. 595.
[298] Tr. 624.
[299] Tr. 635.
[300] Tr. 634, 636.
[301] Tr. 633.

was a relatively inactive and, therefore, weak Board member.[302] But the evidence falls short of establishing that Mr. Odell had the power to control the Foundation's affairs through his relationship and influence with Dr. Zuckerman.

Like Mr. Dougherty, Mr. Hankes provided accounting services to both Mr. Odell and the Foundation at the same time. He had provided the information that Mr. Odell relied on in establishing his asking price for the Odell Corporations,[303] but Mr. Hankes was unaware that Mr. Odell would be using the estimates for that purpose.[304] However, again like Mr. Dougherty, there is no evidence that he provided any advice to the Foundation's Board about the sales or represented the Foundation in any capacity in connection with those transactions. After the Foundation was formed, Mr. Hankes provided services to that corporation as its independent certified public accountant.[305] But unlike Mr. Dougherty, there was no evidence that Mr. Hankes continued to represent Mr. Odell or his corporations after the Foundation was created.[306] The Department claims that Mr. Hankes at least condoned action by the Foundation to pay for automobile insurance for Mr. Odell's personal use after the sales occurred. But the ALJ found that there was always intent on Mr. Hankes' part to settle up and allocate those insurance premiums after he received the year-end financial statements from the accountant for the Odell Corporations. Mr. Hankes was unable to complete that settle-up and allocation because the Foundation's new officers terminated his services before those year-end financial statements became available.[307] The Department also claims that Mr. Hankes may have been involved in efforts to have the Foundation assume liability for $1.3 million in deferred management fees that the Odell Corporations owed Central Health Care Management, his management corporation that had been managing the nursing homes before the sale.[308] However, the ALJ has found that there were conflicting, *bona fide* professional opinions about whether the Foundation was ever obligated to assume those deferred management fees,[309] and there is insufficient evidence of any intent of Mr. Odell to have the Foundation assume those obligations. To summarize, as is the case with Dr. Zuckerman, the evidence falls short of establishing that Mr. Odell had the power to influence the management of the Foundation through his relationship and influence with Mr. Hankes.

The evidence established that Mr. Odell was instrumental in recruiting Messrs. Green and Borg to serve on the Foundation's Board in January and February 1999 after Mr. Dougherty had recommended that the Board be expanded to five members to help the Foundation obtain authority to issue tax exempt bonds.[310] However, the record contains no other evidence tending to establish that Mr. Odell's relationships with Messrs. Green and Borg were such that he would be in a position to influence them as

[302] Finding 23.
[303] Findings 31-35.
[304] Finding 34.
[305] Finding 89.
[306] *See* Finding 17.
[307] Finding 88.
[308] Finding 90.
[309] *Id*.
[310] Finding 65.

Board members. To the contrary, the events that occurred in May and June 1999 tended to establish that there was no potential for Mr. Odell to control the Foundation's affairs by exerting influence on Messrs. Green and Borg.

To summarize, the evidence established that Mr. Odell possessed the potential to control the Foundation's affairs through his relationships with Ms. Blaze and Messrs. Jenson, Dougherty, and Farrington. However, it is unnecessary to determine in this case whether the mere existence of that potential is sufficient to establish the existence of related organization sales because, as is discussed below, the ALJ also concludes that the evidence established that Mr. Odell actually exercised the power to control the Foundation's business affairs.

IV.
Mr. Odell Exercised Control Over the Foundation's Affairs By Influencing Ms. Blaze, Mr. Jenson, and Mr. Farrington and By Taking Advantage of Mr. Dougherty's Multiple Representation

A. Mr. Odell exercised control over the Foundation's affairs by taking advantage of Mr. Dougherty's multiple legal representation.

When the Foundation was being formed and beginning to transact business, Mr. Dougherty was representing the Foundation, the Odell Corporations, and Blaze & Phillips in connection with various business transactions that concerned all of those parties. Although all of those parties had agreed to Mr. Dougherty's multiple representation, it is clear from the record that Mr. Dougherty was not comfortable with the arrangement. He advised the Foundation's Board to obtain separate counsel to represent the corporation in matters relating to the sales.[311] He took the somewhat unusual step of personally instructing the Foundation's directors at a Board meeting about their duty of loyalty to the corporation, notably after it had become clear that the terms of the sales were creating problems for the Foundation.[312] Finally, when it appeared to Mr. Dougherty that the interests of the Foundation and his primary client, Mr. Odell, were in conflict, Mr. Dougherty stopped representing the Foundation.[313] However, even though Mr. Dougherty may not have known of or acquiesced to Mr. Odell's efforts to control the affairs of the Foundation through indirect influence, the evidence established that Mr. Odell did take advantage of Mr. Dougherty's multiple legal representation to aid him in influencing the members of the Foundation's Board. In short, the evidence established that Mr. Odell used Mr. Dougherty's multiple legal representation as a vehicle to control the affairs of the Foundation through indirect influence.

[311] Exh. 515.
[312] Finding 97.
[313] Finding 98.

B. The evidence failed to establish that the purchase price the Foundation paid for the homes was exorbitant.

Although the main purpose of the Related Organization Rule is to ensure that sales of nursing homes are arm's length transactions, the language of the rule itself does not expressly refer to that purpose. The plain meaning of the text of the rule indicates that if evidence establishes that the seller possessed and exercised the "power to control" the buyer, it must be considered a related organization transaction even if the transaction appears to be arm's length in terms of sale price and terms. However, that does not mean that the rule contemplates whether there was "power to control" and whether the transaction was "at arm's length" to be entirely unrelated concepts. Rather, if the evidence establishes that the sale was not an arm's length transaction, that raises a strong inference that the seller was exercising control over the buyer.

The Department essentially argues that the sales in question were not arm's length transactions because the purchase prices that the Foundation paid for the facilities were inflated and exorbitant, but the record fails to support that claim. The evidence established that the Foundation originally paid $8.4 million for the three facilities[314] while Mr. Odell's underlying indebtedness to Home Savings Bank was $3.1 million.[315] To establish that the sales prices were exorbitant, the Department also relied on the testimony of Luverne Hoffman, who testified that Mr. Odell had previously offered to sell him the three nursing homes at about the same price and that he considered the asking price to be too high. On the other hand, in arguing that the prices were not exorbitant, the Foundation relied on the Tisdell appraisals, which indicated market values for all three facilities that were extremely close to the property rate income approaches to value on which the sales prices were actually based.[316] Mr. Hoffman's lay opinion of value was anecdotal and shed only marginal light on what the market value of the facilities might be. On the other hand, the evidence established that a nursing home's ability to generate income for the buyer is primarily dependent on the property rate the Department will pay for Medicaid patients. Thus, the market approach to valuing a nursing home is likely to be more or less congruent with the results of an income approach to value, for it is likely that only consumption would influence a buyer to pay more for a facility than its capitalized earnings would appear to support. This reality is reflected in the Tisdell appraisals. When Mr. Tisdell analyzed comparable sales in his market approach to valuing the three facilities, what he compared was the capitalized income of other facilities to the estimates of capitalized income (i.e., the projected property rates) of the Odell Nursing Homes, which Mr. Betz later found to be erroneously high. Accordingly, if Mr. Tisdell had used correct estimates of the property rates in his income approaches to value, he likely would have arrived at lower appraised values and Mr. Odell's asking prices would have appeared to be higher than what either income or market approaches to value would have supported. But there was no evidence in the record to support an inference that Mr. Hankes had intentionally

[314] Finding 79.
[315] *Id*.
[316] Exhs. 27, 28, and 29.

overestimated the property rates or that Mr. Odell knew before the sales that the income approaches to value on which his asking prices were based overestimated the value of the facilities.[317]

C. The sales of the Odell Homes to the Foundation were not at arm's length because Mr. Odell influenced the Foundation's Board to enter into sales that were unfavorable to the Foundation.

In the final analysis, the ALJ agrees with the Department that the transactions were not at arm's length but for a different reason. The evidence established, among other things, that Mr. Odell used his influence over the Foundation's Board, particularly with Ms. Blaze and Mr. Jenson, to induce them to elevate his interests over the Foundation's, ignore their duty of loyalty and obligation to exercise due diligence on the Foundation's behalf, and to agree to sales transactions that were financially irresponsible for the Foundation.

1. There were no negotiations over the sales.

In consummating the sales of the Odell Nursing Homes, Mr. Odell represented the Odell Corporations, and Ms. Blaze represented the Foundation. But there was no evidence of any negotiations between them.[318] The lack of meaningful negotiations between Mr. Odell and Ms. Blaze over the price and terms of the sales of the facilities can be inferred from a number of facts. First, there is a complete absence of any evidence in the record tending to establish the existence of any negotiations, much less evidence that Ms. Blaze attempted to negotiate terms that were more favorable to the Foundation than what Mr. Odell was asking for his nursing homes. Second, the prices that the Foundation paid for the three nursing homes correlated almost exactly with what Mr. Hankes had estimated in early fall that the property rates of the facilities would be after the sales,[319] and Ms. Blaze had actually worked with Mr. Hankes in developing those estimates for Mr. Odell.[320] One can therefore infer that she had at least a predisposition to accept the asking prices that she had helped develop. Third, on October 15, 1998, Mr. Odell requested Mr. Dougherty to draft asset purchase agreements specifying that the interest rate that the Foundation would be liable to pay to his corporations would be 9%.[321] However, before Ms. Blaze executed those purchase agreements on behalf of the Foundation, Mr. Odell had raised the interest rate to 10%.[322] There is no evidence in the record of negotiations between Mr. Odell and Ms. Blaze regarding the increase in interest rate. The fact that she acceded to an increase in the interest rate that the Foundation would have to pay without evidence of

[317] Mr. Odell may have had some reason to believe that. The evidence established that Mr. Hoffman had told him in 1995 or 1996 that he believed that the property rate on the three Odell Nursing Homes would be insufficient to support the price Mr. Odell was proposing then. (Finding 9.) But that falls short of establishing that Mr. Odell, in fact, knew in the fall of 1998 that the income approaches to value on which his asking prices were based overestimated the value of the facilities.
[318] Finding 58.
[319] Finding 51.
[320] Finding 32.
[321] Finding 51; Exh. 509.
[322] *See* Exh. 13, 14 and 20, all at Tab 1.

any *quid pro quo* for the Foundation is further evidence of the lack of any meaningful negotiations.

2. As the result of Mr. Odell's influence, the Foundation's directors failed to exercise due diligence on the Foundation's behalf.

Neither Ms. Blaze, Mr. Jenson, nor Dr. Zuckerman exercised due diligence on behalf of the Foundation by conducting or obtaining an independent evaluation of Mr. Odell's asking price and sales terms to ensure that they were favorable to the Foundation. As a result, the Foundation incurred debts to the Odell Corporation that it was unable to service.

Ms. Blaze was Mr. Odell's domestic partner. As previously discussed, the ALJ is not persuaded that that fact alone is sufficient to infer a related organization transaction. But it does raise an inference that there might be some reluctance on her part to negotiate vigorously for terms more favorable to the Foundation. And that is, in fact, what happened. As an employee of Mr. Odell, she had been involved in developing the property rate estimate that Mr. Odell had used to establish his asking prices for the three facilities.[323] She did not seek or obtain independent advice on the Foundation's behalf on whether the income stream created by the Department's property rate would be sufficient to service the debt that the Foundation was assuming.[324] She did not obtain independent appraisals of the nursing homes for the Foundation.[325] She did not ask Mr. Betz to confirm Mr. Hankes' property rate estimates *before* the sales occurred.[326] Those steps, particularly pre-sale scrutiny of the property rate estimates by Mr. Betz, would have disclosed that the property rates on which Mr. Odell's asking prices were based were erroneous and would not support the debt that the Foundation was being asked to assume. In short, Ms. Blaze did not do what a reasonable and prudent agent of a corporation would have done to protect and advance the corporation's interests in an asset sale transaction. Rather, it is reasonable to infer that it was Ms. Blaze's personal relationship with Mr. Odell that caused her agree to sales transactions that were not favorable to the corporation for which she was entrusted to act. Other evidence established that the relationship and dealings between Mr. Odell and Ms. Blaze created the *potential* for Mr. Odell to control the affairs of the Foundation by exerting influence over Ms. Blaze.[327] Ms. Blaze's failure to exercise due diligence on the Foundation's behalf to assure that the terms of the sales would be favorable or at least financially viable compels the conclusion that Mr. Odell did, in fact, exercise his potential to control the Foundation's affairs by influencing Ms. Blaze not to look too carefully at what she was agreeing to on the Foundation's behalf.

Much the same is true of Mr. Jenson. He had been employed by the Mr. Odell as administrator of the McIntosh home before it was sold to the Foundation.[328] His

[323] Finding 32.
[324] Findings 58 and 59.
[325] *Id*.
[326] *See* Finding 37.
[327] *See* Part III-A, above.
[328] Finding 22.

employment agreement with Mr. Odell specified that he was to receive $30,000 in compensation if Mr. Odell ever sold that home.[329] Mr. Jenson therefore had a financial interest in the consummation of the sale of the McIntosh home to the Foundation that did not depend on whether that sale was on terms favorable to the Foundation. That was certainly a reason and an inducement for him not to scrutinize the price and terms too closely. He also remained on Mr. Odell's payroll as administrator of McIntosh Manor while he was approving the purchase of the other two nursing homes as a director of the Foundation.[330] The evidence further established that Mr. Jenson did not, in fact, concern himself with whether the sale would be favorable to the Foundation.[331] Because of his prior employment relationship with Mr. Odell, he simply trusted Mr. Odell and Ms. Blaze to handle the whole thing and to ensure that the sale price reflected the new property rate.[332] He made no inquiries of his own into whether the sale price and terms would be sufficient to enable the Foundation even to service the debt, much less generate excess revenue that could be used to further the Foundation's nonprofit purposes.[333] In short, one can also reasonably infer that the financial incentive that Mr. Odell created for Mr. Jenson and Mr. Odell's contemporaneous employment of Mr. Jenson influenced him to agree to any sale, even one that was unfavorable to the Foundation.

Dr. Zuckerman was led to believe that the purchase prices for the facilities were based on independent appraisals.[334] But that was clearly not the case. The purchase prices that Mr. Odell established for the sale of the facilities to the Foundation were actually based solely on the stepped up property rates that Mr. Hankes estimated in September 1998 that the Foundation would receive after it acquired the facilities.[335] However, Dr. Zuckerman did not see his role on the Board as involving himself in the details of the Foundation's business transactions.[336] Rather, he trusted Ms. Blaze and Mr. Jenson to protect the Foundation's interests.

In summary, Mr. Odell offered particular sales prices and terms, and because of Ms. Blaze's relationship with him, she simply accepted those prices and terms on behalf of the Foundation without further question, inquiry, analysis, or negotiation. The other two Board members also did not inquire too deeply into the sales prices and terms—Mr. Jenson because of his economic stake in the transactions and Dr. Zuckerman because of his disinterest in the details. None of them protected the Foundation's interests, and the result was initial sales transactions that met Mr. Odell's financial objectives but left the Foundation completely unable to service the debt it had assumed, thereby forcing it to operate at a loss for several months. In other words, the evidence established that

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[329] Finding 14.
[330] Exh. 201 at p. 170.
[331] Exh. 201 at p. 163.
[332] Exh. 201 at pp. 159-60, 166-67.
[333] Finding 58.
[334] *See* Finding 58 at n. 118, *supra*.
[335] The appraised values by Mr. Tisdell of the three Odell Nursing Homes played no role in Mr. Odell's determination of the purchase prices for the three facilities. Mr. Odell established the purchase prices that the Foundation agreed to on December 7, 1998, and on February 1, 1999, nearly two months before he received the appraisals from Mr. Tisdell. (*See* Exhs. 27, 28, 29, and 509).
[336] Finding 23.

as a result of Mr. Odell's relationship with the three directors, he was able to establish functional control of the Foundation's approval of the sales of the three Odell Nursing Homes. Those sales were therefore not arm's length transactions.

D. After the Foundation was formed, Mr. Odell influenced its Board in its election of officers and additional directors.

After a corporation is formed and initial directors appointed, it is the responsibility of the new Board to select and elect the corporation's officers. Mr. Odell was never a director of the Foundation. Nonetheless, a preponderance of the evidence established that it was he, and not the Foundation's first Board, who decided who the corporation's officers would be. The Foundation's officers were elected not at a meeting of the Board but by written action dated December 1, 1998, the date the Foundation was organized.[337] Mr. Jenson testified that Mr. Odell personally asked him to serve as Vice President.[338] He further testified that he had received that written action from Mr. Dougherty, and that he had no role in preparing that slate of officers.[339] In the absence of any evidence that any other members of the Foundation's original Board were involved in preparing that slate of officers, it can be reasonably inferred that it was Mr. Odell who gave Mr. Dougherty the list of officers to place in that written action. Mr. Odell therefore exercised control over the Foundation's affairs by involving himself directly in the election of its officers. Later in early 1999, it was Mr. Odell, and not the Foundation's existing Board members, who recruited Messrs. Borg and Green to be additional directors.

E. Mr. Odell used his influence in ways that made the Foundation's interests indistinguishable from his own interests.

Mr. Odell was deeply involved in influencing the Foundation's Board to approve a management contract with Blaze and Phillips that was advantageous to him in two important respects. First, the management contract was advantageous to Ms. Blaze who was his domestic partner and with whom he had had a romantic relation for several years. He had previously indicated that when he got out of the nursing home business, it was important to him for her to have a stable employment situation.[340] On advice provided by Mr. Odell's paid consultant, Mr. Farrington, Ms. Blaze first proposed a management agreement that was extremely lucrative for her— monthly payments of $76.00 per patient bed along with 3% of total resident care revenue.[341] Mr. Odell directly involved himself with seeking approval of that agreement on her behalf.[342] It was only Mr. Dougherty's advice to the Foundation Board that those terms might prevent the IRS from denying the Foundation § 501(c)(3) status that prompted the Board to reduce the monthly management fee to 0.5% of total resident care revenue.[343]

[337] Findings 45 and 46.
[338] Exh. 202-1 at pp. 48-50.
[339] Exh. 201 at pp. 165-66.
[340] Finding 11.
[341] Finding 72.
[342] Finding 71.
[343] Findings 63 and 75.

That did not just benefit Ms. Blaze. Later in the spring of 1999, when the Foundation was only able to pay the Odell Corporations enough for them to service their debts to Home Saving Banks, it was Ms. Blaze's income from the Blaze & Phillips management contract that also provided for Mr. Odell's personal needs.[344]

Ms. Blaze's management contract with the Foundation was also important to Mr. Odell because it advanced his own business interests. He believed that Ms. Blaze would manage the Foundation's business affairs in a way that would protect his own financial interests,[345] and that is the way it transpired. In January 1999, it became apparent to all concerned that his asking prices—the prices that the Foundation paid to purchase the Odell Nursing Homes—were based on erroneous estimates of the post-sale property rates that the Department would pay. It further became apparent that the actual property rates that the Department would pay on the transactions as originally structured would be insufficient to service the Foundation's debt to the Odell Corporations. Ms. Blaze then searched for a way to restructure the transactions so that they would protect Mr. Odell's financial interests, and she succeeded in doing so.[346] But later, when the Foundation terminated the Blaze & Phillips management contract, Mr. Odell concluded that the new management would not try to protect his financial interests, and he foreclosed on his mortgages.[347] In summary, after the Foundation was incorporated Mr. Odell exercised control over its business affairs by involving himself, both directly and indirectly through his paid consultant, Bruce Farrington, in the Board's decision to approve the Blaze & Phillips management agreement.

After the Foundation was formed, Mr. Odell continued to pay for the services of Messrs. Dougherty and Farrington and also exercised his power to control the Foundation's affairs by making no distinction between his own business interests and those of the Foundation. His management company, Central Health Care Management, paid for the organizational costs of the Foundation, for the costs that both the Foundation and Blaze & Phillips incurred in connection with preparation and approval of the management agreement between those two parties, the costs incurred in obtaining 501(c)(3) status for the Foundation, as well as for his own transactional costs, without any effort to distinguish between them.[348] Additionally, although Mr. Odell may not have exercised his power to control the Foundation's affairs through his relationship and influence with Mr. Dougherty,[349] that was not the case with Mr.

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[344] Finding 95.
[345] *Id*.; Exh. 201 at pp. 181-83 and 222-23.
[346] The Foundation argued that since the amended purchase agreements were the only ones formally submitted to the Department for purposes of calculating the new property rate, any facts surrounding the consummation of the original purchase agreements are immaterial. The ALJ disagrees. The only reason why the purchase agreements were ever amended was to attempt to correct an unfavorable outcome arising from sales that originally were not at arm's length because the original Foundation Board had been influenced by Mr. Odell not to exercise due diligence before approving them. The two sets of transactions must be viewed as parts of a whole. For purposes of the Related Organization Rule, execution of the amended asset purchase agreements by Ms. Blaze on June 25, 1999, cannot be considered to have erased everything that happened prior to that date.
[347] Exh. 540.
[348] Finding 48.
[349] *See* Part III, above.

Farrington. He had a direct, contractual stake in sales to the Foundation at the highest possible prices. Mr. Farrington was simultaneously performing services for Mr. Odell, Blaze & Phillips, and the Foundation that were all being paid for by Mr. Odell. One can reasonably infer from the evidence that Mr. Farrington knew who his client was, and that client was not the Foundation; it was Mr. Odell. The direct involvement of both Mr. Odell and Mr. Farrington in inducing the Board to approve the Blaze & Phillips management agreement is evidence of that.[350] The ALJ therefore also concludes that the evidence established that Mr. Odell exercised his power to control the Foundation's affairs by frequently treating the Foundation's business affairs as his own.

V.
Conclusion

Minn. Stat. § 256B.431, subd. 14(a) and (d)(7) provides that a nursing home's property rate may be adjusted when it is sold unless the sale is between "related organizations." Under the Department's Related Organization Rule, specifically Minn. R. pt. 9549.0020, subp. 38A, a sale of a nursing home where one party to the transaction "directly, or indirectly … controls" the other constitutes a sale between related organizations. For purposes of the rule, the term "control" includes the power of one party to the sale to control the affairs of the other through indirect influence. Here, the evidence established that Mr. Odell possessed the power to control the Foundation's affairs through his relationships and influence with Ms. Blaze, Mr. Jenson, Mr. Dougherty, and Mr. Farrington. The evidence further established that he exercised that power to control by using his relationships and influence with Ms. Blaze, Mr. Jenson, Mr. Dougherty, and Mr. Farrington to influence the Foundation's Board to agree to purchase the Odell Nursing Homes at prices and terms that were unfavorable to the Foundation, by directly involving himself in the election of the corporation's officers, by influencing the Board to approve a management agreement between the Foundation and Blaze & Phillips that advanced his own interests, and by paying Mr. Farrington to perform work on the Foundation's behalf that benefited him personally. In short, the evidence established that Mr. Odell created the Foundation solely for the purpose of serving his own interests, which included personal interests of Ms. Blaze. He succeeded. For a period of several months following the Foundation's creation, Mr. Odell used his influence to ensure that the Foundation was operated in a way that caused its interests to be largely indistinguishable from those of his own. The ALJ therefore concludes that Mr. Odell was an affiliate of the Foundation within the meaning of Minn. R. pt. 9549.0020, subp. 38A, and that the sales of the Odell Nursing Homes by the Odell Corporations to the Foundation were sales between related organizations within the meaning of Minn. Stat. § 256B.431, subd. 14(a) and (d)(7).

B. H. J.

[350] Findings 68-76.